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ESTATE ACCOUNTING

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8

CONTENTS

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CHAPTER I

DEFINITIONS

A glossary in the back of a book is not likely to be found, much less used, but when fundamental terminology is made Chapter I, it must at least attract attention. This chapter is not to be read for its story, but it should be referred to in the reading of every other chapter.

Many words commonly used are highly technical, one often has two meanings, and there are differences between words seemingly similar which must be understood if the meaning of certain rules of law is not to be obscured or missed. Quarantine has nothing to do with sick persons; Estate may denote an interest in land or it may refer to the property of a decedent; and a Remainder Estate is not the same as the Residue and Remainder of an Estate.

These definitions will not be approved by all readers. Lawyers will object that they are not sufficiently technical and lay readers will complain that they are too much so. An effort has been made to keep them midway between precise legal terminology and the loose talk frequently heard about estates. The sources of these definitions are so numerous that credit could not possibly be acknowledged to all of them. No definition has been taken bodily

from any one source but each has been modified in the light of practical and classroom experience. Most of them have been checked with Bouvier's Law Dictionary, as readers familiar with it will recognize.

GLOSSARY

ABATEMENT. The reduction of a legacy, general or specific, on account of the insufficiency of the estate of the testator to pay his debts and legacies.

ACCOUNT (ING). A statement of the receipts and payments of an executor, administrator, or trustee, of the estate confided to him.

ADEMPTION. The extinction or withholding of a legacy in consequence of some act of the testator which, though not directly a revocation of the bequest, is considered in law as equivalent thereto, or indicative of an intention to revoke.

AD LITEM. For the purpose of a suit or action at law.

ADMINISTRATION. The management of the estate of an intestate, or of a testator who has no executor; broadly applied to include the management of an estate by an executor or trustee.

ADMINISTRATOR. A person appointed by the probate court to receive and distribute the personal property of a decedent who left no will, or of a testator who named no executor competent and willing to serve.

ADMINISTRATOR DE BONIS NON. One appointed to succeed a former administrator who died, resigned, or was removed before his administration was completed.

ADMINISTRATOR, PUBLIC. A public official whose duty it is to administer estates of decedents who have no next of kin, husband, or wife, or when those persons are unknown or absentees.

ADMINISTRATOR WITH WILL ANNEXED. (C. T. A.) One appointed by the probate court to succeed a sole executor

who has died, resigned, or become incompetent either before or after probate.

ADVANCE (MENT). A gift of real or personal property to one to whom the donor stands in the position of a parent, in anticipation of the share of donor's estate which the donee would receive if the donor died intestate.

AFFINITY. The relationship existing because of marriage between each of the married persons and the kindred of the other. (See Consanguinity, for relationship by blood.)

ALIENATION. The transfer of the title and possession of real or personal property from one person to another.

AMORTIZATION. The gradual extinguishment of an asset, e.g., the premium paid for a bond upon its purchase, by regular, periodical reductions, usually calculated on a mathematical basis.

ANCESTOR. A person who has preceded another in a direct line of descent; sometimes used also to designate the person from whom property was inherited.

ANCILLARY ADMINISTRATION. One undertaken in a state where assets are situated but subordinate to the principal administration which usually is in the state of decedent's domicile.

ANNUITY. A fixed sum stipulated to be paid to a person in one or more instalments annually.

ASSET. Broadly, anything of value owned. Estate asset is personal property of the decedent subject to the payment of debts and funeral expenses.

ATTESTATION. The signing by a person as a witness of any written instrument at the request of the person who made or executed it.

BEQUEATH. To give personal property to another by will.

BEQUEST. Same as Legacy (q. v.).

BETTERMENT. An improvement to property rendering it better than a repair would leave it.

BOND. A formal written obligation under seal whereby the

maker agrees to pay money either absolutely or upon certain conditions.

CAPITAL. In business and accounting, the net amount invested in a business venture, the excess of assets over liabilities. In estate accounting, sometimes used synonymously with Principal or Corpus.

CERTIFIED. Confirmed by a written statement signed by one having an official status of public or private nature.

CESTUI QUE TRUST. The beneficiary of a trust; one for whose benefit the trustee holds real or personal property.

CHATTELS. Usually, every kind of personal property. Chattels real are interests in real property less than interests for life. Chattels, whether real or personal, are regarded as personal property in the administration of an estate.

CITATION. A written order issued by a court commanding a person named therein to appear in court on a day named and to do something therein mentioned or show cause why he should not do it.

CODICIL. A testamentary instrument altering or supplementing an existing will. It must be executed with the same formalities as a will.

COLLATION. A term from the Civil law corresponding to Hotchpot (q. v.).

COMMON LAW. Those principles and rules of law expounded by the courts, as distinguished from those laid down in statutes passed by legislatures.

COMMUNITY PROPERTY. Property rights of married persons under a modification of French and Spanish systems of property holding, in use in a few southern and western states.

CONSANGUINITY. The relationship existing among all persons descending from the same stock or common ancestor.

CONVERSION. The change of property from real to personal, or vice versa; see Equitable Conversion.

CORPUS. The capital or principal of a fund as distinguished from its income.

COUNSEL. One or more attorneys advising with reference to legal matters or conducting court proceedings.

COVERTURE. The status of a married woman.

CURTESY. A surviving husband's life estate in land owned by his wife, provided they have had lawful issue born alive.

DECREE. The judicial decision of a litigated matter by an admiralty, equity, or probate court. It differs from a judgment (q. v.) in that a decree may impose conditions upon the person in whose favor it is entered, and it may require something other than the payment of money from the person against whom it is entered.

DEMONSTRATIVE LEGACY. One of money or other property payable out of a particular fund.

DEPENDENT. One who derives support from another; not one who merely derives a benefit from the earnings of the other.

DEPRECIATION. A decline in the value of property reasonably expected to occur because of wear and tear and gradual obsolescence.

DESCENT. The devolution of real property to the heir or heirs of one who dies intestate.

DEVISE. A gift of real property by will.

DEVISEE. One to whom a devise is given.

DISCOVERY PROCEEDINGS. Legal proceedings by which a representative secures possession or control of estate assets wrongfully concealed or withheld from him.

DISTRIBUTION. The division, according to law, among the next of kin, of the residue of an intestate's personal property after payment of debts and charges.

DOMICILE. That place where one has his fixed home, to which when he is absent he intends to return; sometimes determined by law whether or not it is in fact his home.

DOWER. The widow's life estate in one third of all real

property of which her deceased husband had title during coverture.

EMINENT DOMAIN. The right of the government to take private property or to control its use for the public benefit regardless of the owner's wishes, upon reasonable compensation to owner.

EQUITABLE CONVERSION. The change from real to personal property or vice versa, not actually taking place but presumed to exist in order to protect all parties at interest.

EQUITABLE ESTATE. A right or interest in land to which the legal title is held by another, requiring the aid of the court to make it effective.

EQUITY, COURTS OF. Courts applying a system of law more liberal than the common law in order to afford justice where the common law fails to recognize a right or is unable to enforce it.

ESTATE. The degree, quantity, nature, and extent of ownership or interest which one has in real property; not to be confused with estate of a decedent.

ESTATE BY THE ENTIRETY. Ownership of land held by a husband and wife when they are jointly seized, under which each in theory owns the entire land.

ESTATE IN COMMON. Ownership of real or personal property by two or more persons at the same time, not joint but by virtue of separate titles.

EXECUTION. A formal written order which directs an officer to execute or carry into effect a final judgment or decree of a court.

EXECUTOR. A person to whom the carrying out of the provisions of a will concerning personal property has been confided by the testator in his will and who has been duly approved by the probate court.

EXECUTOR DE SON TORT. One "of his own wrong;" one who wrongfully meddles with decedent's property or attempts to perform any acts to be done by an executor.

EXEMPLIFIED. Formally authenticated as a perfect copy of

a record, the signature of the attesting officer being itself attested by some higher officer.

EXEMPTIONS, STATUTORY. In estates, specified personal property of decedent set apart for his immediate family and not subject to his debts or charges against his estate.

FEE. An estate or ownership in land, fee-simple being ownership in one and his heirs absolutely.

FIDUCIARY. One who occupies a position of peculiar confidence towards others, such as an executor, administrator, or trustee.

FOREIGN. Belonging to another country, or in the United States to another state.

FUND. As distinguished from reserve, an asset or group of assets segregated for some particular purpose.

GENERAL LEGACY. A gift by will of money or other thing in quantity not requiring payment out of a particular fund or the delivery of any particular thing.

GIFT CAUSA MORTIS. One of personal property made by the donor in expectation of death to hold good if he dies of a present illness and to be void if he recovers. Delivery is essential and the gift must be absolute, without reservations in favor of donor.

GUARDIAN. One who legally has the care and management of the person or property, or both, of a child until he becomes of age.

HEIRS. Persons to whom decedent's real property descends immediately by operation of law in the absence of a disposition of it by will; does not include surviving husband or wife.

HOLOGRAPHIC WILL. One entirely in testator's handwriting.

HOTCHPOT. The blending or mixing of property of an intestate belonging to different heirs or next of kin so that it may be divided according to statute; accomplished by considering all advancements (q. v.) as part of the property to be divided.

INCOME. In estate accounting, the proceeds produced by principal, the profit which comes from its use.

INCUMBRANCE. Any right to or interest in land which lowers its value but does not prevent its transfer.

INFANT. A person under 21 years of age.

INHERITANCE, ESTATE OF. Ownership in land which will descend to one's heirs.

INTANGIBLE. Not material or subject to perception through the sense of touch.

INTESTATE. One who dies without leaving an effective will; sometimes applied to decedent's property which was not disposed of by will.

INVENTORY. In estate accounting, a written list or schedule of estate assets.

ISSUE. One's descendants.

JOINT ESTATE. Ownership in land by two or more persons under one conveyance; upon death of one, his interest passes to survivor or survivors.

JUDGMENT. The conclusion of law by a court of law upon facts found or admitted to be true in a litigated proceeding.

JUDICIAL SETTLEMENT. In New York Surrogate's practice, a settlement or approval of the accounts of an executor, administrator, guardian, or testamentary trustee, conclusive as to all matters included in the proceeding upon all persons cited in it.

JURISDICTION. The authority by which a court or other judicial officer takes cognizance of and decides matters.

KIN (DRED). Persons legally related by blood; sometimes used to include those related by marriage.

LAPSED LEGACY. One which fails because legatee predeceased testator.

LEGACY. A gift of personal property by will.

LEGATEE. One to whom a legacy is given.

LETTERS OF ADMINISTRATION. Document issued by probate court conferring authority upon an administrator.

LETTERS TESTAMENTARY. Document issued by probate court confirming the authority of one named in a will as executor.

LIFE ESTATE. Ownership in land held by one for his own life or for the life or lives of one or more other persons.

LIFE TENANT. In estate accounting, one who has the use of property or income from it for his own life or the life of another.

LINEAL DESCENDANT. One in a direct line, as from father to son to grandson.

MORTALITY TABLE. A statistical table showing the proportion of a large group of persons, usually 100,000, which will probably live to reach each age up to the death of the last person; inferentially establishing the expectancy of life of the average person of each age.

NEXT OF KIN. Persons to whom decedent's personal property is distributed by operation of law in the absence of a disposition of it by will; does not include surviving husband or wife.

NON COMPOS MENTIS. Mentally incompetent from any cause.

NUNCUPATIVE WILL. An oral one or one in writing but not formally executed, disposing of personal property; permitted for soldiers in actual military service and sailors at sea.

OATH. A form of attestation by which one signifies that he is bound in conscience to perform some duty faithfully.

ORDER. A written direction of a court or judge not included in a decree or a judgment.

PENDENTE LITE. During a litigation.

PER CAPITA. Per or by heads or individuals, share and share alike.

PER STIRPES. By or according to family or parent.

PERPETUITY. A provision in the disposition of property which would suspend the power of transferring it for a period longer than a life or lives in being; and at common law, for twenty-one years thereafter.

PERSON INTERESTED. In estate accounting, any one entitled to share absolutely or contingently in the estate except as a creditor.

PERSONAL PROPERTY. All property which is neither real property nor rights inseparably connected with real property.

PETITION. A written prayer or request to a court or judge for the granting of some remedy or relief.

PRECATORY WORDS. Expressions in a will praying or requesting that a thing shall be done.

PRIMOGENITURE. The status of being the first born, or the eldest.

PRINCIPAL. In estate accounting, the corpus or capital as distinguished from the income; the property of a decedent left at his death; or the property which forms the subject matter of a trust.

PROBATE. Relating to proof of wills by judicial or court action. Probate courts or judges in some states are known by other names. See Surrogate.

PROPOUND. In estate accounting, to offer or proprose a will for admission to probate.

QUARANTINE. In estate accounting, the right of a widow to remain in her deceased husband's principal mansion for forty days immediately after his death.

REAL PROPERTY. Land and whatever is erected upon or growing on it and certain rights inseparably connected with the land. Roughly, real property is immovable whereas personal property is movable.

REALIZATION. Conversion into cash.

REMAINDER. A future estate, created at the same time as another and precedent estate (known as the particular estate) and to be enjoyed on the termination of the latter.

REMAINDERMAN. One who is entitled to a remainder estate after a precedent and particular estate has expired.

REPAIRS. Work done to property to keep it in good condition, but not resulting in a betterment.

REPLACEMENTS. New property substituted for old property which has been retired, without such an increase in value as would constitute a betterment.

REPRESENTATIVE. In estate accounting, an executor or administrator.

RESIDUARY DEVISEE. One to whom is given a devise of all the rest, residue, and remainder of testator's real property not otherwise effectually disposed of by will.

RESIDUARY LEGATEE. One to whom is given a legacy of all the rest, residue and remainder of testator's personal property not otherwise effectually disposed of by will.

RESIDUE. That portion of a decedent's estate which is left after the payment of debts and charges and the satisfaction of all legacies and devises.

REVERSION. That remnant of an estate which remains in a person after he has transferred to another some lesser estate, such as one for years or for life.

SITUS. Situation or location.

SPECIFIC LEGACY. One of specified property distinguished from all other articles of the same kind.

SPOUSE. A husband or wife.

SUCCESSION TAXES. Taxes on the passing of property on the death of the owner, his donees being his successors to the property.

SURROGATE. A term used in New York to denote a probate judge. He is a county officer with local and limited jurisdiction.

TANGIBLE. Susceptible of proof through the sense of touch.

TESTAMENT. A will.

TESTAMENTARY TRUST. One created by a will.

TESTATOR. One who dies leaving a will; the term testatrix is sometimes applied to a woman decedent who leaves a will.

TITLE. The legal right to ownership of property.

TRANSFER TAX. The New York inheritance tax, being the tax on the transfer of property at death.

TRUST. A conveyance to a person called the trustee, of real or personal property, coupled with a direction that it be devoted to the benefit of a third person, called the beneficiary or cestui que trust.

TRUSTEE. A person appointed by will or deed or by a court, who holds some estate, interest, or power in or affecting property of any kind for the benefit of another.

VESTED. Carrying an immediate, fixed right of present or future enjoyment.

WAIVER. In estate accounting, a written relinquishment or refusal to accept a right.

WILL. One's solemn declaration in legal form making disposition of one's property, taking effect at death but revocable during life.

CHAPTER II

OUTLINE OF ADMINISTRATION

To provide a comprehensive view of the administration of an estate, this chapter outlines the usual course from decedent's death, through the final accounting, to the ultimate distribution of assets. On page 16 this is summarized in a graphic chart.

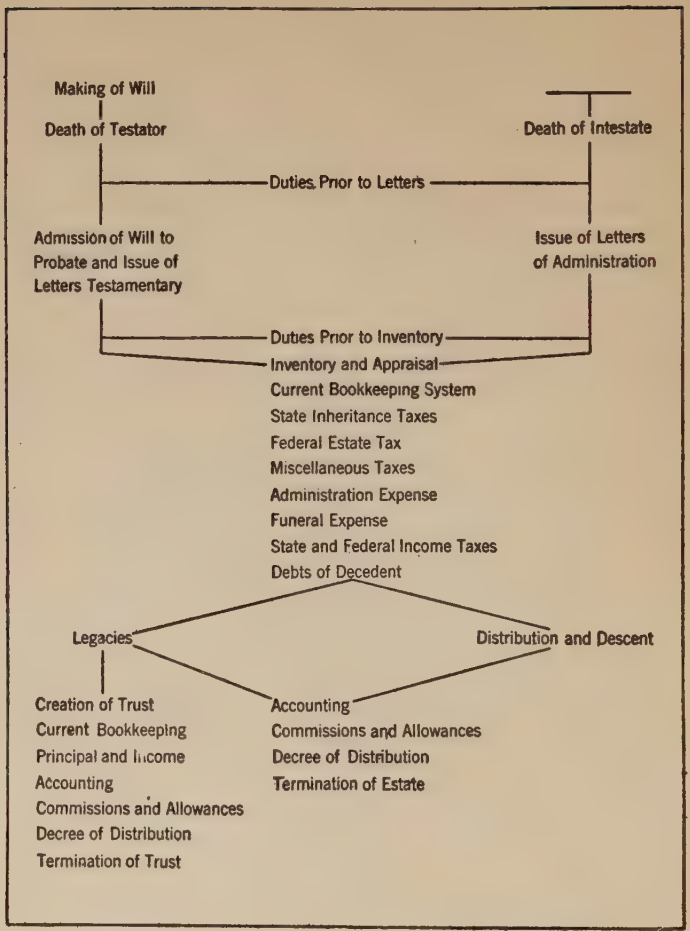
One dies either with or without leaving a document which purports to be his will. Formal approval by the court is required to establish the validity, as a legal will, of a document purporting to be a will left by the decedent. If the person named as executor does not propound the will, it may be offered for probate by anyone else interested in the estate. If the person named in the will as executor is one of whom the court approves as to age, residence and responsibility, letters testamentary are issued to him, as the official evidence of his authority. Before their issuance, the executor is required to take an oath of office and generally to file a bond. A provision in the will relieving an executor from filing a bond does not bind the court. When there is no will, letters of administration are issued to an administrator. These are similar to letters testamentary. The law usually designates the persons to whom letters of administration may be issued; if no eligible person can be found, letters are issued to a public administrator. The duties of the administrator in the main are similar to those of an executor.

The representative, i.e., executor or administrator, should at once prepare an inventory of the estate assets. In this he may be aided by the inheritance tax authorities. The representative should then open suitable books of account. The system should depend upon the size and complexity of the estate. In small estates very simple records will suffice, but in most cases complete double entry books should be kept. Accurate records should be made because the representative must be prepared to account precisely, and they should be preserved because his acts may be questioned long after he has accounted. One of the first matters requiring attention is inheritance taxation which is both vexatious and important. Not infrequently a third or more of the estate is dissipated in meeting it. Estates are subjected also to income taxes, usually both state and federal, and to various local taxes. A few of the most simple aspects of inheritance taxation are discussed in Chapter X.

The expense of administering the estate is given precedence over other expenses and debts. The representative should ascertain what he may legally pay for such expenses. If he makes an unauthorized payment, the loss will fall on him personally. Early in the administration, the representative is confronted with the payment of funeral expenses, subject to approval by the court, and here again the representative will be charged personally with improper payments. After the payment of administration and funeral expenses, the payment of decedent's debts must be undertaken. Since there can be no certainty that all such debts are known, the representative is usually permitted, but seldom required, to advertise for creditors

to present their claims. It is usual for the law to prescribe some order of preference among debts but this order is important only in cases where the funds are not sufficient to pay all of the debts. In that event, the representative may render himself personally liable if he pays without regard to the prescribed order of precedence. The representative then distributes the cash and other personal property among the persons entitled to it under the terms of the will, or by law in the absence of a will. Where the estate funds are ample, this distribution is a simple matter, but otherwise the executor should be well advised by counsel.

The final stage of administration begins with the rendering to the court of a statement of the representative's transactions, in the form of an account, showing cash and other personal property received, the disposition made of it, and the remaining balance. The preparation of this account is greatly simplified by the keeping of adequate books of account. The account must be approved by the court, whereupon the court issues a decree of distribution directing the disposition of the balance. The representative is given a remuneration, usually commissions on the moneys which have passed through his hands, and he is allowed a sum for his expense in preparing his account. In the decree of distribution, he is directed to retain his remuneration and expense allowance and then to distribute the remaining assets to the persons entitled thereto. When he has made this required distribution, his work as representative is completed, but he may be called upon at any time thereafter to render a further account if evidence of negligence or wrong-doing is discovered.



Graphic Outline of Administration of Decedent's Estate

Where a will provides that certain properties or sums of money are to be given to the executor or to some other person as trustee for some specific purpose, the carrying out of the trust provisions is no part of the work of the executor. Such duty falls upon the testamentary trustee, although he may be the same person as the executor. The trustee must conserve the trust fund and dispose of it in accordance with the terms of the trust. He is a fiduciary having duties entirely apart from those of an executor and receiving a separate remuneration.

The diagram on page 16 is an effort to present the foregoing summary in graphic form, indicating the relationship between the administration of a decedent's estate and the administration of a trust. In general, the duties of an executor and of an administrator coincide. The work of a testamentary trustee begins after the legacy which creates the trust has been paid by the executor, and thus on the graphic outline, testamentary trusts are shown under legacies.

CHAPTER III

ISSUE OF LETTERS—ESTATE ASSETS

Duties Prior to Letters

Law and Practice.—Formerly, the representative could do anything before probate which did not require him to produce evidence of his authority. Today, he usually has no power to dispose of any part of the decedent's estate except to pay funeral expenses. He should, however, do everything necessary to preserve the estate.

Ordinarily he should propound the will for probate and he should notify life insurance companies in which decedent left policies payable to his estate, and banks in which decedent had accounts. He may accept security by a surviving partner for buying out decedent's interest in accordance with a partnership agreement. He may pay estate cash to discharge an apparently valid obligation of decedent's to complete a contract for the purchase of land in another state, but he must ratify this act after letters are issued. He cannot compel debtors to pay him, but his receipt will release such debtors as do pay. If without fraud or deceit, he settles with a creditor, such settlement binds the creditor. The issue of letters to him legalizes all proper acts prior to their issue; for example, it has been held that payment by a bank to decendent's widow prior to her appointment as representative is legalized by her subsequent appointment. The subsequent

issue of letters does not legalize the obtaining of money or the doing of acts by coercion of any sort.

Current Bookkeeping.—As a rule, the representative's formal books of account will not have been opened at this time. He should, however, make an accurate record of all of these transactions for subsequent entry in his books. Such a record may be made in his check book stubs or in any other convenient form. Memorandum journal entries should be made covering the performance of each important act.

Accounting.—Acts prior to letters are not accounted for, as such. Because the issue of letters legalizes such acts, if proper, each receipt and payment of cash prior thereto should be reported in the account in conjunction with other items of the same nature received or paid after the issue of letters.

Issue of Letters

Law and Practice.—So far as estate accounting is concerned, there is little of interest in the issue of letters. Letters testamentary and letters of administration are the official evidence of the authority of, respectively, the executor and the administrator. The representative should procure certified copies for use in securing the transfer to him of decedent's bank accounts and other estate assets in the possession of third persons. When necessary to apply for ancillary letters, an exemplified copy will usually be required.

Letters testamentary are procured by having the will

admitted to probate and by satisfying the court that the person named in the will is competent to serve. The proceedings for admission to probate may be initiated by anyone legally interested in the settlement of the estate and the surviving husband or wife and the heirs and next of kin must be cited. Devisees and legatees should be cited in order to secure jurisdiction over them. After the admission of the will, the person named as executor must qualify or renounce within a reasonable time, usually specified by statute. A bond may be required even though testator has expressly waived it. An attempt to reduce the expense of a bond sometimes is made by depositing estate securities, in lieu of a bond with a larger principal sum, but the fees charged by the depositary may equal the premium on a bond.

Letters of administration are issued to persons designated by statute as eligible. In New York the order of eligibility is definitely prescribed, from husband or wife, at the top of the list, to the next of kin who is entitled to the smallest share. If no competent person can be found among the eligibles, letters are issued to the Public Administrator.

Letters may be cancelled or revoked for cause; if the offense is sufficiently serious, notice in advance need not be given to the representative.

Current Bookkeeping.—The payment of all expenses in connection with the admission of the will and the securing of certified or exemplified copies, constitutes part of the administration expense and the bookkeeping for it is discussed under that caption. Memorandum

journal entries should be made, and the references to the public records should be noted in the journal, as advised in Chapter V.

Accounting.—The admission of the will to probate and the issue of letters are noted in the affidavits which form part of the representative's accounting, but they are not involved in any way in the financial portion of it.

Estate Assets

Law and Practice.—Estate assets consist of decedent's personal property which is subject to the payment of his debts and funeral expenses. They usually are itemized in the statutes but in general they include all personal property, whether or not in the state, with only a few exceptions for a surviving widow, husband, or minor issue. These usually include a small amount of money, certain articles regardless of their value (for example, the family Bible, photographs, and school books), and certain articles such as housekeeping utensils, furniture, and clothing not to exceed a fixed value. All other personal property must be collected and applied according to law.

If damages can be collected by the representative for negligently causing decedent's death, they usually do not become estate assets but should be paid to the widow, husband, or next of kin. Life insurance is an asset only when payable to decedent's estate. If a statute gives creditors a right against insurance on a deceased man in favor of his widow, purchased with premiums exceeding a stated amount per year, the proceeds are for the use

of creditors and are not estate assets. This involves difficulty when varying types of insurance are covered.

Care must be taken to differentiate between real and personal property. Claims for damages to realty are assets if the damage occurred prior to death and so also are claims against the government for taking realty through eminent domain. An uncollected balance on decedent's contract to sell real property is an asset but realty which decedent contracted to buy is not. Private letters of the decedent are not estate assets, although they might have a market value. A debt due to decedent is not cancelled by his naming his debtor as executor. The executor is charged when it becomes due, as if it were so much cash in his hands, if he is solvent at any time before his final accounting. A cancellation of a debt by will is merely a specific legacy. One deduction from estate assets is a widow's right to quarantine and sustenance, under which she may remain in the house of her husband for forty days after his death, whether or not her dower is sooner assigned, and have her sustenance out of her husband's personal estate. This provision usually is in addition to family exemptions.

The representative must collect all estate assets. His inventorying, care, and investment of them are discussed in Chapter IV.

Current Bookkeeping.—Each important asset, or each group of assets, should have a separate ledger account, to be debited with the value of the asset as shown by the inventory and credited with the same amount when the asset is sold or distributed. A gain or loss on a sale

need not be shown in the asset account. Gains and losses should appear in separate accounts to facilitate the preparation of the representative's accounting. Chapter V shows an asset record to support or take the place of asset accounts.

Accounting.—The representative charges himself with the inventory value of assets received, and with all gains on sales. He takes credit for all losses on sales and for inventoried assets which he was unable to collect or secure. A balance shown by the account must be represented by assets on hand.

Partnership of Decedent

Law and Practice.—The death of a partner terminates the partnership and the legal title to partnership property vests in the surviving partner or partners. They have full power to liquidate the business or to manage it, if it is to be continued, and the representative of the deceased partner has only a right to an accounting for the value of decedent's partnership interest as at the date of death, which is an estate asset. He cannot interfere in the liquidation or management but he should prevent fraud. Unless the will provides otherwise, he should withdraw decedent's interest as soon as practicable, because it is a hazardous investment not permitted by law. An executor may sell decedent's interest to the surviving partners even though some of them are co-executors, provided he secures a fair value. If he continues the business or continues testator's interest in it, he becomes chargeable personally with all losses but must account to the estate for

all profits. In ascertaining the value of decedent's interest, the good will of the partnership is an asset of the firm. Inventories usually valued at cost or market, whichever is lower, may be valued at replacement costs because the estate is selling its interest in them to the survivors.

The period within which the partnership must account must be reasonable in each case. It has been held that two years is not per se too long a time. It is usual to engage public accountants to determine decedent's interest, but the representative ex officio has no right to examine the firm books.

Current Bookkeeping.—The value of decedent's interest may be recorded as nominal until it has been appraised, when the ledger account should reflect its appraised value. If for any reason the settlement of decedent's interest includes profits earned after his death, such profits should be credited to Income.

Accounting.—A partnership interest requires no comment beyond that given under Estate Assets.

Mortgages

Law and Practice.—When an owner of land borrows money and gives the lender, as collateral security, a right to collect out of the land, the owner who is the debtor becomes the mortgagor, and the lender becomes the mortgagee. The mortgagor has assumed a personal obligation to repay the loan and his land has become charged with the loan as collateral security. The mortgagee has thus acquired two rights; one against the mortgagor person-

ally, known as a right in personam, and one against the land, known as a right in rem. The first of these rights is the principal or primary one, the one in rem being for security. If the mortgagor defaults, the mortgagee may foreclose by having the land sold and the debt satisfied out of the proceeds. If the proceeds exceed the debt, interest, and expenses, the surplus belongs to the mortgagor. If they are insufficient, the mortgagee may secure a judgment against the mortgagor for the deficiency.

If the mortgagor dies, the land passes to his devisees or heirs subject to the right against it held by the mortgagee. Logically, the mortgage debt should be paid out of the mortgagor's personal estate, from which all debts are primarily payable, and the land should be utilized only through foreclosure, which devisees or heirs could prevent by payment. In New York, the devisees or heirs are made responsible for the mortgage debt to the extent of the value of the land, the personal estate being liable for any deficiency. In such states, the representative should not pay the mortgage debt. If the mortgagee dies, the right *in personam* for the collection of the debt is an asset of his estate, while the right against the land passes to his devisees or heirs, in trust for his personal estate. The mortgagee's representative should obtain the proceeds upon a foreclosure. Upon foreclosure after the mortgagor's death, any surplus belongs to his devisees or heirs, on the theory that it replaces that part of the land which was not required in the payment of the mortgage debt. His personal estate would be charged with the payment of a deficiency. Upon foreclosure after the mort-

gagee's death, a deficiency judgment would be an asset of his estate.

Current Bookkeeping.—The mortgagor's representative should make a memorandum entry for the mortgage because the estate is under a contingent liability for any deficiency upon foreclosure. The mortgagee's representative should record the mortgage debt as an asset, making a memorandum entry for the mortgage as security.

Accounting.—If a mortgagor's or a mortgagee's representative accounts prior to the maturity of the mortgage debt, he should list the actual or contingent assets and provide for the actual or contingent liabilities.

Contracts to Sell or Buy Realty

Law and Practice.—If decedent contracted to sell realty, he obtained an obligation on the vendee's part to pay cash and decedent's title became subject to his obligation to convey it to the vendee upon collection of the cash. If decedent died prior to the conveyance, title to the land passes to his devisees or heirs, subject to the obligation to convey to the vendee. The right to collect any balance of the selling price is an asset of his estate. Formerly, the devisees or heirs could be compelled to convey the land to the purchaser but today the representative is usually given power to execute the deed, subject to confirmation by the court.

If decedent had contracted to buy realty but had died prior to securing title, any unpaid portion of the contract price would be a debt of his personal estate. Dece-

dent's right to secure the land is an interest in the land itself and passes to his devisees or heirs, who can compel the representative to pay this debt.

Current Bookkeeping.—The representative of a decedent who had contracted to sell realty, should record any uncollected portion of the selling price as an estate asset and should make a memorandum entry describing the land. The representative of a decedent who had contracted to buy, should make a memorandum entry of the transaction. Liabilities need not be recorded in the ledger until they are paid.

Accounting.—The comments under Mortgages are applicable here.

Equitable Conversion

Law and Practice.—Mortgages and decedent's contracts to sell and buy realty involve equitable conversion, which is a change from real to personal property or vice versa, not actually taking place but presumed to exist. Property is subjected to rules applicable to it in its changed and not its original form, although the change may not actually have occurred. The right of devisees or heirs, charged with the payment of a mortgage debt, to receive the surplus after foreclosure, depends upon equitable conversion. If land is devised to trustees to convert it into cash by sale, the interest of the beneficiary is treated as personalty. But a mere discretionary power to sell would not work a conversion.

Recently, a North Dakota vendor contracted to sell

New York land but died before collection of the price. The land was not subject to tax as being tangible property in the state left by the deceased vendor, because all that his estate had was a claim against the vendee for whom the land was held in trust. In another case, land was condemned for use by a railroad but the owner died before proceedings were completed. Damages awarded for the land belonged to his personal estate, because what he left was not land but a claim for damages. Proceeds of fire insurance on a barn burned five days before death of the assured, were held to be realty, particularly since the insurance company had the option of rebuilding the barn. The benefits of the policy were held to inure to those who would reap them in case of its literal performance.

The representative must not assume that cash invariably is personal property and land real property. By equitable conversion, the situation might be exactly reversed. In all cases of doubt, he should secure advice of counsel to avoid personal loss.

Current Bookkeeping—Accounting.—Property subject to equitable conversion should be recorded and accounted for as if a physical change had taken place.

CHAPTER IV

INVENTORY AND CARE OF ASSETS

Discovery of Assets

Law and Practice.—If the representative believes that some person has possession of decedent's personal property to which the representative is entitled, he may institute discovery proceedings to secure it. If such property has been exchanged for other property or sold, the New York Court under a 1924 statute may direct that the new property or the proceeds of the sale be given to the representative. Discovery proceedings are useful in securing possession of estate assets but they can be used for no other purpose. They cannot be employed to compel a bank to pay a balance in decedent's account, because that would be collecting a debt since the relation between a bank and its depositor is that of debtor and creditor. Nor can they be used to secure an accounting from a debtor.

Current Bookkeeping.—When an asset not covered by the original inventory is secured, the representative should record it in a proper ledger account, the offsetting credit being to Estate account. The expense of discovery proceedings is properly classified as Administration Expense. (See Chapter VI.)

Accounting.—No special treatment of the expense of discovery proceedings or of assets procured by them is required in the representative's accounting.

Inventory

Law and Practice.—An inventory of the estate assets is usually required by statute, but in any event one should be prepared to protect the representative. An inventory is prima facie evidence of the extent and value of the assets and any creditor or other person who objects to it must prove that it is wrong. If it shows an account receivable as bad or doubtful, anyone claiming that the account is collectible must prove it. Failure to file an inventory is evidence of a desire to conceal improper conduct. A provision in a will that no inventory need be filed is void. Schedules listing all property, real and personal, are required for inheritance taxation and although more inclusive than the inventory are usually accepted in lieu of it. An inventory rarely can be impeached directly, but it may be attacked collaterally in any proceeding, for an accounting or otherwise, by alleging that assets were omitted or undervalued. If an inventory is required, the filing of it can be compelled.

Real property need not be included because the representative normally is concerned only with personalty. Decedent's debts may be ignored because the inventory is merely a list of assets and not a statement of financial condition and the filing of an inventory is usually required before the expiration of the time allowed for ascertaining debts. Life insurance payable to beneficiaries other than the estate should not be included.

The inventory should be a list of all of decedent's personal property, although part of it may not be in decedent's state, unless the will appoints another executor for the state where the property can be found. Intangible as well as tangible personal property is to be included; for example, decedent's interest in a partnership, money due on contract, and all other accounts receivable, even though some of them may be cancelled by will. The inventory should show accrued interest belonging to the principal of the estate. Securities and other property pledged as collateral for debts due by decedent should be included at their full value without deduction for these debts.

An appraisal by appraisers appointed by the court is sometimes required. Appraisers usually are paid at daily rates, and hence the representative should prepare the inventory in advance, listing articles in the order in which they can be found. The appraisers then can work quickly, examining each article and noting its value. Any rearrangement of the inventory, for example, to group all furniture items together, will be less costly than having appraisers retracing their steps or searching through schedules to find the listing of a particular article.

In the appraisal of bonds, notes, and other securities or accounts full particulars concerning each item should be given; for example, name of debtor, date executed and date collectible, sum originally collectible, amount collectible at decedent's death, and sum which in the appraiser's judgment can be collected at maturity. Securities sold in open markets should be appraised at market prices, using the range of the market through a reasonable

period of time if there were no sales on the appraisal date. The valuation of securities not commonly sold is more difficult. Their book value would not necessarily fix their fair market value for appraisal. If ownership would carry control of the corporation which issued them, they might be worth more than book value. Sometimes competent persons are asked to testify to the price they would be willing to pay for the securities. A New York case fixed the value of common stock without a market by deducting outstanding preferred stock from the net value of the assets, including goodwill. The goodwill was valued for this real estate corporation, in business for ten years, by ascertaining the average net profits during the last preceding three years, from that average deducting interest at 6% on the average net invested capital and multiplying the excess, as income from goodwill, by five.

Articles exempted for decedent's family should be appraised like estate assets, but shown in a separate schedule of the inventory. The representative is not charged with them but he may have to show that they came within the law as to kind and value. Assets outside the state cannot be appraised without the consent of persons in possession because they are beyond the court's jurisdiction, but such assets can be secured through ancillary letters in the state where they are found.

Current Bookkeeping.—When the inventory is completed, the representative by journal entry should debit an account for each kind of asset with its appraised

value, and credit the total to an account called Estate, or Principal. (See Chapter V.)

Accounting.—The inventory is the first item in the representative's account and he charges himself with the amount of it. (See Chapter VIII.)

Care and Investment of Assets

Law and Practice.—The representative must be diligent in securing possession of all assets. Any loss due to neglect or delay may be charged to him personally. He must make vigorous efforts to collect all accounts due, even when debtors live outside the state, but he should not incur expense in trying to collect hopelessly bad accounts. He should use the same effort in collecting accounts and securing assets and the same care in preserving them that a reasonably prudent business man would use under the same circumstances with accounts and property of his own. Stock certificates in decedent's name should be transferred to the representative. To secure transfer he will usually need to present a certified copy of his letters and a waiver, or written consent, from the inheritance tax authorities of his own state and of each state wherein the corporation is incorporated or has property. The representative is not an insurer of the assets and he will not be responsible for loss if he exercises the required care. He should insure against fire or theft if reasonable prudence indicates the advisability of it. He may insure decedent's buildings if there is any likelihood of an insufficiency of the personal estate

to meet taxes, expenses, or debts. (See Chapters VI and VII.)

In a solvent estate, articles of a personal nature are usually distributed among legatees or next of kin at their inventoried value. If this cannot be accomplished amicably, such articles should be sold unless a substantial loss would result, in which event the court should order distribution or sale. If joint representatives cannot agree as to custody or disposition of assets, the court may order a proper disposition of assets. Personal property may be sold at any time for the payment of taxes, expenses, debts, or legacies, local statutes prescribing whether the sale should be public or private, for cash or on credit. Articles not specifically bequeathed and not necessary for the support of the family should be sold first. In an unusual case an executor personally may purchase at the sale, provided he discloses his official position, or he may "bid in" the property if all offers are too low.

As a rule, the representative merely collects and distributes estate assets and he need not invest funds, unless this duty is imposed upon him by will or by statute or unless it arises by necessity when settlement of the estate is delayed. He is governed by rules applying to trustees. The rate of income to be obtained is rarely fixed by law but it should be the average on safe investments, at the time and place where he is acting. Cash on hand can be used for the payment of taxes, expenses, and debts, and in proper cases, of legacies, but no improper payment will be credited to the representative. Necessary payments seldom exhaust all estate cash and the balance should remain on deposit in a bank of good standing, in

the name of the estate. All estate funds should be so deposited as soon as they are received and all payments should be made by check. An account may be opened before issue of letters but the bank will not honor checks until it has been served with a certified copy of the letters.

In New York, a representative who mingles estate funds with his own or who deposits them without indicating their fiduciary character, is guilty of a misdemeanor, is subject to the revocation of his letters without notice, and is personally responsible for the entire amount so deposited, in case of loss, regardless of his care in selecting the bank. Nevertheless, the mingling of estate funds is frequently discovered. A representative may deposit in a bank in which he is a stockholder, director, or even cashier, but not in one of which he is virtually the owner. A temporary checking account need not draw interest, but on a large account likely to remain for a year or more, at least 2% should be obtained. The representative is not personally responsible for loss through bank failure if there was nothing to lead a reasonably prudent man to refrain from depositing or to withdraw funds already deposited. But the representative is liable if the deposit was not necessary, if the funds should have been used in making payments, if he made the deposit for a fixed time, or if he might reasonably have known that the bank was not entirely safe. The representative should notify all banks in which decedent had accounts because a bank's authority to pay checks is revoked by depositor's death. But a bank paying a check in good faith, without knowledge of or reason to suspect depositor's death, is not liable to the estate for

the payment. This rule is based, as one court stated it, "on principles of necessity incident to the banking business."

When necessary, a New York representative may invest in the kind of securities permitted for savings bank investments and in first mortgages on New York real estate worth at least 50% more than the loan. Approved securities are enumerated at length in the law; they do not include corporate stocks or bonds (except those specifically mentioned) or properties outside the state and beyond the court's jurisdiction. Practically every decedent leaves investments which would not be legal for his representative. Unless the will directs otherwise, they should not be continued longer than necessary to prevent loss. The representative should be conservative even under a liberal will.

Current Bookkeeping.—The representative must record the gain or loss on the sale or realization of each asset. Where bonds are purchased at a premium or discount, the adjustments noted in Chapter IX must be made, and the purchase or sale of accrued interest must not be confused with the price paid or received for principal. Brokerage and taxes on each purchase and sale should be recorded.

Accounting.—The gain or loss on the realization or sale of assets and all income and expense in connection with their investment must be reported in the accounting.

CHAPTER V

SYSTEM FOR CURRENT BOOKKEEPING

Necessity for Accurate Records.—The representative must keep current records because otherwise his accounting will be merely approximate. An approximate accounting appearing exact would be accepted in the absence of objections but it could not withstand an attack. It might result in a surcharge against the representative personally. The law does not prescribe estate bookkeeping, nor does it as a rule prescribe the form of account at the end of the administration, but a representative who fails to keep adequate records may be charged personally with the expense of preparing his account. Further, he might be called upon to explain transactions long after his account had been rendered.

In designing a system of bookkeeping, the requirements of the final accounting should be kept in mind, but it is possible to go too far in that direction. Stationers occasionally offer books of account which follow the form of accounting so closely that these books themselves are intended to serve as the representative's accounting. This is not recommended because the representative should not part with his books, and because few courts would accept them as the account to be filed. A system based wholly upon the form of the final account would give the required figures but as items should be classified otherwise than simply according to chronological order, it

would still be necessary to analyze the various accounts. A double entry system following the general outline below is practicable in large estates without being cumbersome for small ones.

Outline of System.—At the beginning, the inventoried values of assets are debited to accounts with appropriate titles, each asset or group of assets having one account. For example, there should be an account with each bond and mortgage, each kind of capital stock, each bank deposit, and each kind of personal property, such as library, jewelry, furniture, and clothing. The credit to offset these debits is made in total to an account entitled Estate, which represents Principal. Subsequent receipts of money are debited to cash and subsequent receipts of property to the proper asset account. Cash receipts from the sale of assets are credited to the accounts of the assets sold; receipts of cash or property existing at the time of death but which for some reason were not recorded on the books, are credited to Estate; for example, when an asset was discovered after the books had been opened. Cash receipts on account of income earned by the estate during administration are credited to an account entitled Income.

Payments of cash or distributions of assets are credited to the proper asset accounts. Expense payments are debited to an account entitled Expense Principal if they are to be borne by the persons entitled to Principal; they are debited to Expense Income if they are to be borne by those entitled to Income. Decedent's debts are not recorded as liabilities but payments of them are deb-

ited to an account entitled Debts. Payments or distributions to legatees are charged to accounts with the legatees. Finally, nominal accounts are closed into Estate and Income and the credit balances in those accounts are distributed among the legatees' accounts, each being credited with the amount of his legacy.

Where one person is both executor and trustee, the trust transactions must be kept distinct. Usually an executor's administration is concluded before any substantial transactions on account of the trusteeship occur, but a separate set of books for the trusteeship should be kept even though that necessitates the running of two sets during part of the time.

The books of account required for the system proposed herein are a journal, a cash book, and a ledger. These are described and their principal uses outlined below.

Estate Journal.—The journal may be an ordinary two column one, the distinctive feature proposed being memorandum entries, thus making it a sort of diary. The representative should keep a record of all important transactions, so that if his conduct is questioned at any time he can refresh his memory. Such memoranda can conveniently be kept in the journal. Facts rather than conclusions should be stated and exact references to extraneous documents and files should appear. Noting the folios of public records where estate papers are recorded saves time when it is necessary to consult the records or to give references to them.

The first memorandum entry should give the exact

date of death. The next might refer to the reading of the will and recite specifically the acts of the person named as executor before his appointment. It should show when and from whom he obtained the will, because sometimes several are found and it is difficult to determine which was the last authentic one. The representative should note his employment of counsel, giving the attorney's name and address, a statement of his agreement concerning compensation, and a word or two as to his reasons for engaging him. If heirs and next of kin are unknown, he should note the steps taken to locate them and to get the other information required for the petition for admission of the will. As soon as their names are ascertained, he should enter them in his journal, specifying the sources of his information. If the representative secures possession of or information concerning assets before the issuance of letters, he should note what assets are involved and what he did prior to his appointment. If he opens a bank account he should record the name of the bank and that the account was opened in the name of the estate. A memorandum entry should be made also to show the date of the petition for the admission of the will.

The admission of the will and the issue of letters should be recorded. The appointment of appraisers for the inventory and the sending of notices of appraisal should be noted and the journal should show what steps were taken to have property exempted from inheritance taxation. A notation should be made of the court order directing the representative to advertise for creditors, naming the newspaper and giving dates of publication.

An actual advertisement should be pasted in the journal, and under it a copy of the affidavit of publication, the original being kept for filing with the accounting.

The first financial transaction usually recorded in the journal is to open accounts for assets shown by the inventory. Thereafter, few financial transactions need to be entered in it. Among them are deposits and checks with inactive bank accounts; the recording of assets discovered after the inventory; profits or losses on assets other than upon cash sales; the charging of legatees with inheritance taxes, the total of which may have been debited first to a suspense account as explained below; distributions to legatees of estate assets other than cash, and the closing of nominal accounts.

Estate Cash Book.—A specially ruled cash book in the form shown on pages 46, 47 is recommended. This requires only a columnar book which can be readily purchased. Date, folio, check number, and voucher number columns are omitted from the form because they are not peculiar to estate accounting.

On the receipts side, the net cash column should show all cash received to be carried in the checking account. If more than one checking account is used, a net cash column for each bank should appear on each side of the cash book. The cash book should not include inactive accounts carried to secure interest. The column entitled Income is to record all cash receipts to be credited to persons entitled to the income, including prorated portions of interest collected, accrued subsequent to the date of death. Two columns showing respectively the

gain and loss on realization of assets, combine a journal function with the cash book, and are convenient for recording in one place the collection or sale of an asset to show its book value, the cash collected, and the resulting profit or loss. The column headed Sundries contains all items to be credited individually to ledger accounts.

On the payments side, the net cash column should record each check drawn. The columns for Expense Principal and Expense Income contain items to be charged to those accounts in total at the end of the administration or at the end of any fiscal period, as, for example, one ending with the preparation of an intermediate account. The column headed Debts should contain all payments on account of them, to be posted in total like the two preceding columns. The column, Sundries, contains all items to be debited individually to ledger accounts.

Estate Ledger.—The estate ledger may be a small, bound book in ordinary double entry form. If accounts receivable or investments are numerous, subsidiary records or ledgers may be used in any convenient form with controlling accounts in the estate ledger.

Illustrative Case.—An example of the application of this system in a New York estate is given below. Details have been eliminated as far as practicable. The method of recording each type of transaction should be studied in connection with its appropriate chapter. Many of these transactions are discussed later in the book but the system is introduced here because it seems more

in accordance with the usual chronological order of events in an actual administration. The Federal estate tax and the New York inheritance, or transfer, tax, have been computed under the law effective on May 31, 1924. Readers who are sufficiently interested to check the amounts of these taxes, should ignore all amendments, decisions, and rulings since that date. In this illustrative case, are certain practical short cuts which constitute slight deviations from the general outline of the system but these are explained in the text comments on Current Bookkeeping under each subject.

Statement of Facts

A New York testator, a widower without minor children, died January 15, 1923.

His will contained the following provisions:

A legacy of $10,000 to Samuel Thompson (not a relative).

A legacy of his jewelry to his daughter, Jane.

A devise of his New York City real estate to his son, George.

The rest, residue and remainder of his estate, real and personal, to the X Trust Company, to pay the income therefrom to his daughter, Grace, during her life, and upon Grace's death, the remainder to his son, Edward.

The property left by the testator was appraised as follows:

Clothing and personal effects	$ 1,000.00
Jewelry	1,500.00
Household furniture	2,000.00
Cash in hand and on deposit in a checking account	3,400.00
750 shares of Coal Company stock (par value $75,000)	60,000.00
50 bonds of Steamship Company, 6% Jan. & July, Par $1,000 each	50,000.00
Life Insurance payable to Estate	75,000.00
Life Insurance payable to other beneficiaries	45,000.00
New York City real estate	100,000.00

On January 15, 1923, the daughter, Grace, was 39 years old.

The executor's cash receipts were as follows:

Interest on bank deposit	$ 200.00
Coal Co. dividend declared Jan. 31, 1923	3,000.00
Interest on Steamship Co. bonds	3,000.00
Life Insurance	75,000.00
Sale of all household furniture	2,500.00
Sale of all clothing and personal effects	600.00
Refund on Transfer Tax	182.37
Collection of Transfer Tax from son, George	1,567.50

The executor's cash payments were as follows:

Probate and other administration expenses	$ 5,500.00
Funeral expenses	700.00
Debts of testator	2,500.00
Expenses chargeable to Income	1,100.00
Advance to Thompson on his legacy	5,000.00
Deposit on account of New York Transfer Tax	4,800.00
Federal Estate Tax	5,064.24

The jewelry was delivered to the daughter, Jane.

The New York Transfer Tax was settled at $4,617.63 chargeable as follows:

Samuel Thompson	$ 475.00
Son, George	1,567.50
X Trust Co., trustee	2,575.13

The executor submitted his account for judicial settlement and he was allowed $100.00 for his expense in preparing it and $3,974.00 for his commissions of which $119.22 was chargeable to Income.

The executor retained $4,074.00 to cover his allowance and commissions and distributed the remaining assets in accordance with the decree of distribution.

Journal Entries Prior to Accounting

Clothing and Personal Effects		$ 1,000.00
Jewelry		1,500.00
Household Furniture		2,000.00
Cash	(Posted from Cash Book)	3,400.00
Coal Company Stock, Par Value $75,000		60,000.00

Steamship Company 6% Bonds...	50,000.00		
Accrued Interest on Steamship Company Bonds	125.00		
Life Insurance payable to Estate.....	75,000.00		
Estate			$193,025.00
To record the Inventory at Appraised Values.			
Jane, Legatee	1,500.00		
Jewelry			1,500.00
To record the delivery of the specific legacy.			
Samuel Thompson, Legatee	475.00		
X Trust Company, Legatee	2,575.13		
Transfer Tax Suspense			3,050.13
To charge the legatees with the transfer tax.			
Estate	11,500.00		
Samuel Thompson, Legatee			10,000.00
Jane, Legatee			1,500.00
To record these legacies.			

TRIAL BALANCE PER ACCOUNTING

Coal Company Stock .....$	60,000.00	$
Steamship Company Bonds	50,000.00	
Estate		167,860.76
Cash	64,785.63	
Income		4,975.00
Samuel Thompson, Legatee		4,525.00
X Trust Company, Legatee	2,575.13	
	$177,360.76	$177,360.76

JOURNAL ENTRIES AFTER ACCOUNTING

Estate	$163,905.98		
Income	4,855.78		
X Trust Company, Legatee			$168,761.76
To record legacy.			
X Trust Company, Legatee	110,000.00		
Coal Company Stock			60,000.00
Steamship Company 6% Bonds			50,000.00
To record transfer of securities on account of legacy.			

Receipts — CASH BOOK

ACCOUNT TO BE CREDITED	PARTICULARS	CASH	INCOME	REALIZATION OF ASSETS		SUNDRIES
				Gain	Loss	
(Posted from Journal)	Cash per Inventory	3,400.00				3,400.00
Income	Interest on bank deposit	200.00	200.00			
Income	Coal Co. Dividend	3,000.00	3,000.00			
Income	Bond Interest	3,000.00	2,875.00			
Acc. Int, on Bonds	Bond Interest	.....				125.00
Life Insurance	Collection of Policy	75,000.00				75,000.00
Household Furniture	Proceeds of sale	2,500.00		500.00		2,000.00
Clothing and Effects	Proceeds of sale	600.00			400.00	1,000.00
Transfer Tax Suspense	Refund by State	182.37				182.37
Transfer Tax Suspense	Collection from George	1,567.50				1,567.50
Receipts		89,449.87	6,075.00	500.00	400.00	83,274.87
Balance per Accounting		64,785.63				64,785.63
Total per contra		64,785.63				64,785.63

Payments

CASH BOOK

ACCOUNT TO BE DEBITED	PARTICULARS	CASH	DEBTS	EXPENSE		SUNDRIES
				Principal	Income	
Estate	Administration Expenses	5,500.00		5,500.00		
Estate	Funeral Expenses	700.00				700.00
Estate	Debts	2,500.00	2,500.00			
Income	Expenses	1,100.00			1,100.00	
S. Thompson Legatee	Cash Advance	5,000.00				5,000.00
Transfer Tax Suspense	Cash Deposit	4,800.00				4,800.00
Estate	Federal Estate Tax	5,064.24				5,064.24
Payments		24,664.24	2,500.00	5,500.00	1,100.00	15,564.24
Balance per Accounting		64,785.63				64,785.63
Total per contra		89,449.87	2,500.00	5,500.00	1,100.00	80,349.87
Estate	Expense of Accounting	100.00				100.00
Estate	Executor's Commissions	3,974.00				3,854.78
Income	" "	.....				119.22
S. Thompson, Legatee	Cash Payment	4,525.00				4,525.00
X Trust Co., Legatee	Cash Payment	56,186.63				56,186.63
Payments		64,785.63				64,785.63

ESTATE

Loss on Sales....C	400.00	Inventory.....J	193,025.00
Expenses.....C	5,500.00	Gain on Sales.....C	500.00
Debts.....C	2,500.00		
Funeral Expense..C	700.00		
Federal Estate TaxC	5,064.24		
Legacy to Thompson.....J	10,000.00		
Legacy to Jane....J	1,500.00		
Balance per accounting.....	167,860.76		
	193,525.00		193,525.00
Expense of accounting.....C	100.00	Balance per accounting.....	167,860.76
Executor's Commissions.....C	3,854.78		
Legacy to Trust Company.....J	163,905.98		
	167,860.76		167,860.76

CASH

Inventory and Receipts.....C	89,449.87	Payments before accounting.....C	24,664.24
		Balance per accounting.....	64,785.63
	89,449.87		89,449.87
Balance per accounting.....	64,785.63	Payments after accounting.....C	64,785.63

INCOME

Expense.....C	1,100.00	Cash Collections...C	6,075.00
Balance per accounting.....	4,975.00		
	6,075.00		6,075.00
Executor's Commissions.....C	119.22	Balance per accounting.....	4,975.00
Legacy to Trust Company.....J	4,855.78		
	4,975.00		4,975.00

SAMUEL THOMPSON, LEGATEE

Cash Advance....C	5,000.00	Legacy.....J	10,000.00
Transfer Tax.....J	475.00		
Balance per accounting.....	4,525.00		
	10,000.00		10,000.00
Cash.....C	4,525.00	Balance per accounting.....	4,525.00

CLOTHING AND PERSONAL EFFECTS

Inventory.....J	1,000.00	Cash and Loss on Sale.....C	1,000.00

JEWELRY

Inventory.....J	1,500.00	Delivery to Jane, Legatee.....J	1,500.00

HOUSEHOLD FURNITURE

Inventory.....J	2,000.00	Cash and Gain on Sale.....C	2,000.00

COAL COMPANY STOCK (PAR VALUE $75,000)

Inventory.....J	60,000.00	Delivery to Trust Company, Legatee J	60,000.00

STEAMSHIP COMPANY 6% BONDS

Inventory.....J	50,000.00	Delivery to Trust Company, Legatee J	50,000.00

ACCRUED INTEREST ON STEAMSHIP COMPANY BONDS

Inventory.....J	125.00	Cash Collected....C	125.00

LIFE INSURANCE PAYABLE TO ESTATE

Inventory.....J	75,000.00	Cash Collected....C	75,000.00

TRANSFER TAX SUSPENSE

Cash Deposit.....C	4,800.00	Cash Refund.....C	182.37
		Collection from son George.....C	1,567.50
		Charged to Legatees J	3,050.13
	4,800.00		4,800.00

JANE, LEGATEE

Jewelry delivered..J	1,500.00	Legacy.....J	1,500.00

X TRUST COMPANY, LEGATEE

Transfer Tax.....J	2,575.13	Legacy.....J	168,761.76
Cash.....C	56,186.63		
Delivery of Securities.....J	110,000.00		
	168,761.76		168,761.76

Page 52 shows a record of assets based on forms used by trust companies. This is valuable in a large estate with many securities, and in a small estate it can be used for all assets. When so used in conjunction with a check book, complete books of account need not be kept. It is wiser, however, to use a double entry system in even the smallest estate.

The proposed form as printed has been substantially reduced in size. The form itself for actual use should be approximately 11 x 18 inches. Unit rulings for money columns are advisable. In a small estate a printed form would not be necessary but the suggested headings or similar ones could readily be noted at the tops of the columns of ordinary analysis or columnar journal paper which can be purchased at any large stationery store. In designing a form for an estate, care should be exercised to provide for each item of information which is likely to be useful. The form shown on page 52 is intended chiefly to be suggestive.

ESTATE OF....., Deceased

RECORD OF ESTATE ASSETS

Date of Death.....
Place of Death.....
Residence.....
Ancillary Administration in.....
Legacies and Other Information.....

Will Dated.....
Petition for Letters Filed.....
Will Admitted to Probate.....
Letters Granted.....

Transfer Tax Deposit Paid.....
Transfer Tax Settled.....
Federal Estate Tax Due.....
Federal Estate Tax Paid.....

.....

.....

Description of Asset					Par of Bonds or Number of Shares	Quotation	Value	Int. Acc'd thru Date of Death	Unpaid Dividends Declared Prior to Death				Annual Div. or Int. Dates	State of Incorporation	Transfers				Disposition of Asset	Cash Realization			Remarks
Name of Company	Pfd. or Com.	Par Value	Int. or Div. Rate	Maturity					Declared	Books Closed	Payable	Amt.			Inh. Tax Ret. Filed	Tax Paid	Waived Rec'd	Negotiable		Cash	Gain	Loss	

CHAPTER VI

DEBTS—ADMINISTRATION EXPENSE—FUNERAL EXPENSE

Advertising for Creditors

Law and Procedure.—All of decedent's debts may not be known at his death. Personal books are rarely kept so completely and all of decedent's books may not even be discovered. The representative is permitted to advertise for creditors and he is not required to make any distribution of assets until it has been completed. Advertising consists in inserting notices, generally weekly, in one or more newspapers published in the county, requesting persons who have claims to present them with vouchers to the representative on or before a specified date, usually six months from the first notice. In rural communities and small towns advertising is probably effective, but in large cities its value is doubtful. One newspaper selected is almost certain to be that which prints legal notices and court calendars, and is commonly seen only by attorneys. Advertising at least delays settlement of the estate until creditors have had a chance to discover decedent's death. When not compulsory, it may be omitted in small estates, but only when there is no reason to suspect undisclosed debts.

The representative must protect creditors as well as legatees and other beneficiaries and he may be charged

personally with a proper debt if he distributes estate funds without providing for it, unless he has protected himself by advertising. After advertising, he will not be charged personally with any debt subsequently presented unless he had knowledge of it before making the distribution. The representative's protection is the chief reason for advertising but incidentally it usually shortens the time, commonly one year, within which administration can be completed. When advertising requires but six months, the administration may be concluded within seven or eight.

Current Bookkeeping.—Memorandum entries should be made in the journal to record each step in the advertising. In the cash book, payments for advertising should be entered as Expense Principal.

Accounting.—If the representative has advertised, he should note it in the affidavit accompanying the account. All expenses in connection therewith should appear in the Administration Expense schedule.

Payment of Debts

Law and Practice.—"Debts" may be defined as "every claim and demand, upon which a judgment for a sum of money, or directing the payment of money, could be recovered in an action." The representative should pay just debts, but he should reject unjust ones and interpose the statute of limitations or any other defence available for decedent. He may follow definite instructions in the will to waive legal defences, but he is not authorized

to pay illegal "debts of honor" which would be unenforcible. Since he cannot pay debts barred by the statute of limitations, a partial payment by him does not revive the debt. He may nevertheless deduct a debt due to testator but barred by that statute, in paying a legacy to the debtor. (See Chapter VII.) Creditors who fail to present their claims within the time prescribed by law have no rights against a representative who does not know of their claims, but they may sue persons to whom assets have been distributed. The precedence of debts, given below, applies in such actions.

Each claim must be supported by vouchers and an affidavit that it is justly due. The representative may either admit or reject a claim, but his admission must be positive. In New York, the validity of a claim is established only when the representative acknowledges it upon his accounting "or has theretofore in writing admitted or allowed it." He has a reasonable time to pass on claims and he should carefully scrutinize supporting vouchers, because many claimants realize that death has removed the person best qualified to oppose their claims. The representative should reject a claim by written notice. The creditor may then sue him or he may again present the claim on the settlement of the representative's account. Claims not yet due and payable should be admitted, to establish their validity for future payment, and provision should be made for them upon the settlement of the representative's account. A doubtful claim may be settled by a reasonable compromise in good faith. It may even be fully paid in good faith and in reasonable fear that litigation might go adversely even though later it

proved to be invalid. An inadvertent overpayment to a creditor in an estate later found to be insolvent can be recovered from the creditor.

An estate is solvent when there are sufficient funds to pay taxes, administration expenses, funeral expenses, and debts. In an insolvent estate, the representative may incur a personal loss unless he observes the legal order of precedence for these claims. In New York, the order in which debts rank for payment is as follows:

1. Debts entitled to a preference under the laws of the United States and the state of New York.
2. Taxes assessed on the property of the deceased previous to his death.
3. Judgments docketed, and decrees entered against the deceased, according to the priority thereof, respectively.
4. All other debts.

Examples of the first group are customs duties, forfeited bonds to the United States, and claims against deceased office holders for government funds not accounted for. Under the second group, assessments for improvements on realty are generally held to be liens on the property to be paid by the heir or devisee. It is only in the third group that any preference within a group can be recognized, with the one exception of rent noted below. A judgment cannot be rejected by the representative because it is a debt, the validity of which has been established. In the fourth group rent due on leased premises held by decedent is sometimes preferred when it will benefit the estate. A debt due and payable is not to be preferred to one not due. The commencement of an action or the obtaining of a judgment after decedent's

death does not entitle the debt to preference. A debt due to the representative personally is not only not entitled to preference but it must not be paid at all until it is approved and allowed by the court. A debt not yet due may be paid if it is discounted at the legal rate of interest. When the creditor will not consent to the discount, a sum sufficient to pay the debt in full can be retained upon the settlement of the representative's account.

In the payment of debts, the personal estate constitutes the primary fund or source of payment. Unless the will directs otherwise, debts are payable from the following sources, in order: (1) assets not bequeathed, (2) assets bequeathed generally, (3) assets bequeathed specifically, (4) realty not devised, (5) realty devised generally, (6) realty devised specifically. Testator's intent will be observed as far as practicable and thus property given to specified persons will not be withheld from them for paying debts until all other property has proved insufficient. (See Chapter VII on abatement when bequeathed personalty must be used in paying debts.) The procedure by which realty is made available for debts may be outlined as follows. The representative petitions the court for an order permitting him to mortgage, lease, or sell real property for the payment of debts, showing that the personal property is insufficient. All interested persons are cited, and if proper, the court issues an order directing the representative to mortgage, lease, or sell the whole or some specified part of the real property. It is customary for the court to confirm or reject the disposition of realty made by the representative.

The persons to whom decedent's real property would

pass if it were not necessary to use it for decedent's debts may prevent such use of it by giving a bond conditioned to pay all approved debts charged against the land. If it is necessary to dispose of realty, the law fixes the order in which distinct parcels shall be utilized. In New York, the order is:

1. Property which descended to decedent's heirs and which has not been sold by them.
2. Property so descended which has been sold by them.
3. Property which has been devised but which has not been sold by the devisee.
4. Property so devised which has been sold by the devisee.

Testator's planned distribution of his estate will be disturbed as little as possible. All dower or curtesy rights and estates for life or years in property to be sold will be adjusted and heirs or devisees must be reimbursed if any assets are subsequently discovered, from which the debts could have been paid.

Real property may be mortgaged, leased, or sold when necessary for the payment of inheritance taxes, funeral, or administration expenses, and when the will specifically directs that certain debts or certain legacies be paid out of it.

The rights of individual and firm creditors when the decedent had been a member of a partnership should be noted. Firm creditors must first make every reasonable effort to collect from a surviving partner, but they need not sue if he can be shown to be bankrupt, or "judgment proof" through having so many judgments against him that another one could not be collected. They may then

have recourse to the estate of the deceased partner, but in this they are postponed to decedent's individual creditors, who extended credit solely in reliance on decedent's separate property, whereas the firm creditors relied primarily on partnership assets. Individual creditors reach firm property indirectly because decedent's interest in the partnership is an estate asset. All debts of every kind must be paid before legatees or next of kin, devisees or heirs, can receive any part of decedent's property.

Current Bookkeeping.—Liability accounts need not be opened for decedent's debts, but payments of debts should be charged to an account called Debts of Decedent. Since this account will be closed into Estate at the time of accounting, it is convenient to charge the total of the Debts column in the cash book directly to Estate when more than one accounting is unlikely. If upon accounting, the representative is ordered to retain money to meet a contingent liability or one not then due and payable, all of his ledger accounts may be closed except one to represent the cash or other asset retained and one to show the liability to be met. Estate account may be kept open for that purpose and the payment of the liability charged to it.

Accounting.—In his account, the representative takes credit for debts paid. A supporting schedule should show the amount and description of each debt, together with a reference to its voucher. The number of each voucher should be noted on the schedule and in the cash book.

Administration Expense

Law and Practice.—Administration expenses are reasonable and necessary outlays by the representative in collecting and distributing assets and are entitled to precedence over all other expenses and debts.

The representative decides what he may properly pay subject to approval by the court. If a payment is not ultimately credited to him, he remains charged personally with it, but reasonable payments in good faith are usually sustained. The representative can rarely bind the estate by any contract for administration expenses. He makes himself personally liable on contracts of this kind, but payments will be credited to him on his accounting if they fall within legal limits. As a rule, he need not use his personal funds but may pay from estate cash. The representative's commissions or other compensation are not strictly administration expenses but constitute compensation for his duties, one of which is to keep administration expenses low. For that reason, among others, he must not withdraw any part of his commissions during administration but he must wait until the court directs payment on his accounting. Court costs and allowances for his expenses of preparing his accounting are not administration expenses but are charges against the estate specifically allowed by the court. Since administration expenses are preferred over debts, it is important to determine when claims against the estate or payments made constitute allowable expenses. In a New York case, judgment was rendered against the representative in an action brought to collect a claim due the estate,

This judgment was held to be an administration expense, to be paid even though the estate was insolvent and creditors could receive nothing.

It is difficult to indicate all possible expenses which will be allowed, but expenses which have been disallowed furnish a guide. For certain expenses obviously proper, an excess over a fixed maximum will be disallowed. For instance, in New York, the premium on the representative's bond must not exceed 1% per annum on its amount. The representative is allowed only a reasonable time to break up decedent's home and to continue household servants needed to care for assets and show them for sale. He is not permitted to employ an assistant for work which he himself should do, but he may hire clerks for non-administrative duty; he is not allowed to engage an attorney to collect interest, look after repairs, and procure tax bills, but if collections of rent are numerous, he may employ a collector; he may not retain an attorney to search for the will, procure his bond as representative, and take papers to court, but he may have one to prepare a petition for his appointment. Traveling expenses will be allowed if necessary; a person named as executor may travel to New York City when the will is to be admitted to probate, but subsequent trips will be disallowed if employment of a local agent would have sufficed.

The necessity and reasonableness of ordinary expenses are presumed and any interested person who objects has the burden of proving them improper. The controlling factors are the character and amount of the estate and the complications of administrative control. In general,

any disbursement not connected with the routine of administration will be disallowed. The representative will not be credited for payments to an attorney in lunacy proceedings against the widow and sole legatee. In an Ohio case, the deceased made a valid contract to will property to B but died intestate. Although the heir was represented by counsel in defending suit by B, the administrator also retained counsel. B won. The administrator was not allowed credit for attorney's fees and expenses because it was not his duty to conduct this litigation.

The allowance of fire insurance premiums is well settled if a reasonably prudent business man would insure similar property of his own under similar circumstances. A representative who failed to insure or to continue insurance taken out by decedent might be penalized in case of loss. He should insure buildings only when there is a probability of an insufficient personal estate. Before he cancels insurance on buildings taken out by decedent, he should give the heirs or devisees an opportunity to pay him the unearned premium prorated on a time basis, because both they and the estate will lose if the policies are cancelled at short rates.

The largest administration expense is likely to be attorney's fees. Reasonable counsel fees are always allowed, but the allowance is to the representative and not to the attorney. Courts have held that fees must have been paid by the representative before he can secure credit for them. He must exercise reasonable care in selecting his attorney, because he will not be allowed to employ other attorneys to correct mistakes made by a

first one. Testator cannot compel his executor to engage a lawyer named in the will. If the representative is an attorney admitted in the state, fees may be allowed him as counsel in addition to his compensation as representative.

The amount of counsel fees depends upon the size of the estate, time required, difficulty of questions involved, nature of service rendered, standing of counsel, and results attained. If a lawyer who can command large fees chooses to render services to a small estate, he must be content with small fees.

If the personal estate is insufficient to pay administration expenses, real property may be utilized in the same way as for the payment of debts.

Current Bookkeeping.—Administration expenses are ultimately chargeable to Estate account. Each payment should be entered in the Expense Principal column of the cash book. Where there is but one accounting, the total of that column may be posted at once to Estate account, but otherwise an account for Expense Principal should be used.

Accounting.—In the summary of his account, the representative takes credit for the total administration expenses which are itemized in a supporting schedule, on which payments of a like kind are grouped with subtotals extended.

Funeral Expense

Law and Practice.—Funeral expense frequently includes petty graft because unscrupulous persons are aware

that grief makes the family averse to critical scrutiny. Courts examine funeral expenses as carefully as other payments and a representative should know the general limits beyond which his expenditure will be disallowed. Funeral expenses are those necessary to carry the body, decently covered, to the place of burial, to mark the spot, to have suitable burial ceremony, and to provide adequate mourning clothes for relatives dependent upon deceased for financial support. All must be reasonable in view of decedent's religion, age, standing, property, and habits. If creditor's rights might be jeopardized, the rule is strict; otherwise, it is liberal.

If decedent died away from home, transportation charges to take the body home are allowed. The amount for a tombstone depends chiefly upon the value of the estate after provision for debts has been made. In a $17,000 estate, a $2,000 expenditure was reduced to $1,000 and in an estate of $2,410 an expenditure of $1,050 was disallowed. Funeral expenses of $329.50 in a $500 estate were reduced to $150. Relatives must pay personally for a funeral more elaborate than the size of the estate would warrant, and this applies although the will specified the amount to be paid. The entire amount of a specified bank account or fund can not be used if that amount would be unreasonable. A reasonable charge for the perpetual care of the burial lot or a moderate legacy in trust for keeping the grave in repair are proper funeral expenses. In one case, a woman was buried in a dress given by will to a legatee. Its value was paid to the legatee and allowed as a funeral expense.

Reasonable mourning apparel for members of the fam-

ily dependent on deceased for support will be allowed, but vouchers must be procured. The representative will not be allowed credit for a lump sum. One case disallowed the cost of refreshments at a cemetery. As a rule, the last illness expenses will not be allowed as funeral expenses. The more logical view is that they are debts of decedent and entitled to no preference. Prompt payment of funeral expenses can be compelled. Although payable primarily from the personal estate, realty may be utilized if necessary, as in the payment of debts.

Current Bookkeeping.—In a small estate, funeral expenses may be charged directly to Estate. They should not be entered in the Expense Principal column of the cash book because that is intended for administration expenses. In a large estate, a separate account for funeral expenses should be kept.

Accounting.—In the summary of his account, the representative takes credit for total funeral expenses, a supporting schedule showing the details.

CHAPTER VII

LEGACIES—DESCENT AND DISTRIBUTION

Legacies

Law and Practice.—A legacy is a gift of personal property by will, the donee being called a legatee. A gift of real property by will is known as a devise and the donee as a devisee. Legacies are classified as general, specific, and demonstrative.

A general legacy is one payable out of the general assets, being a gift of money or other thing in quantity, not in any way separated or distinguished from other things of like kind. It does not require the delivery of any particular thing or the payment of money out of any particular fund. A general legacy usually is a gift of money but it may be one of live stock, if the animals are not designated; of a number of shares of capital stock, without designation of the certificates; of a fractional portion of the contents of a safe deposit box; or of any other property not specifically identified. The provision, "I give one One Thousand Dollar Victory Bond to my cousin," was held a general legacy because a particular bond was not given.

A specific legacy is one of specified property distinguished from all other articles of the same kind; for example, a gift of a watch "which I received from my father." A legacy is specific when payment, destruction, or cancellation during testator's lifetime would have

destroyed the bequest, because a specific legacy fails if its subject does not exist at testator's death. A specific legacy carries with it interest or income on its subject matter after testator's death, but one of property not income producing does not draw interest.

A demonstrative legacy is a gift of money or other property payable out of a particular fund. If the fund is insufficient, the balance becomes a general legacy. Interest or income on the fund after testator's death belongs to the general income of the estate because a demonstrative legacy is general rather than specific.

Legacies are payable from the personal estate unless an intent that real property be used is evident from the will, or circumstances at the time of its execution. Legatees must prove that intent. It is not proved by showing the condition of testator's property when the will was made if it appears that he thought his personal estate would be sufficient at his death. If a legacy is expressly or by implication charged upon real property, the procedure for utilizing the realty is the same as in the payment of debts. Legacies are postponed to debts, because it is only his net estate that testator can give away. They are postponed also to taxes, administration, and funeral expenses.

Property specifically bequeathed cannot be used to pay debts, taxes, or expenses until property generally bequeathed has been exhausted, because preference for specific legatees is presumed from testator's identifying specific portions of his personal estate. In a doubtful case a legacy will be construed as general rather than specific, to protect the legatee under the rule that a spe-

cific legacy fails if its subject matter is not in existence. Such a failure, known as ademption, is accomplished by alienation, extinction, or substantial alteration of the subject matter prior to testator's death. The legacy fails if testator disposed of or destroyed the property or so altered its nature that it ceased to be the thing contemplated when the will was made.

In a solvent estate, the burden of expenses, debts, and taxes not payable by legatees and devisees, falls upon the residuary legatee because he is given all the residue of the estate not otherwise disposed of or required for expenses and debts. If the estate is not sufficient to meet these charges and all legacies and devises, the latter are reduced or abated. After the residuary legatee the next group to suffer is the general legacies. When they have been exhausted, the specific legacies are abated, demonstrative legacies being included among them for abatement. If then there is not sufficient property to meet charges and debts, the devises are subject to abatement through utilizing the realty. Abatement in each group is pro rata with the individual legacies or devises.

A legacy or devise fails or lapses if the legatee or devisee predeceases testator but not if he dies after testator but before delivery of the legacy or devise. In the latter situation, the estate of the deceased legatee or devisee becomes entitled to the legacy or devise. A lapsed legacy leaves property undisposed of by will which passes to the residuary legatee. A legacy or a devise to testator's child or other descendant or to his brother or sister usually does not lapse when the legatee or devisee predeceases testator, but leaves a descendant who survives the testator.

A legacy or devise is void when it is illegal or when there is no legatee or devisee competent to take it. Void legacies like lapsed ones fall into the residuary estate.

Legacies are not payable at once, but generally one year after death or upon completion of advertising for creditors. If the will directs or the court orders immediate payment, or if the legatee needs prompt payment, the executor should take a bond from the legatee, to reimburse the estate if abatement should prove necessary. General legacies bear interest from the date when they are payable, such interest being chargeable against estate income because the unused funds have earned income. Interest has been allowed to general legatees even though estate assets had been unproductive. If a general legacy is paid before it is due, interest should be charged to the legatee and credited to estate income, and an executor who fails to secure such interest may be charged personally. General legacies to testator's children dependent on him for support usually bear interest from date of death.

The executor should make all required deductions from legacies, the most common one being for state inheritance taxes. A debt due by a legatee to the testator should be deducted because a legacy by a creditor to his debtor is not even a prima facie release of the debt. A debtor who becomes a legatee cannot retain funds applicable to the payment of all charges and legacies. Interest on such a debt runs from its maturity to the time of the payment of the legacy. Nor does a legacy by a debtor to his creditor cancel the debt, because legacies are payable only after debts have been satisfied. A contingent debt due

from a legatee may be deducted, as in one case where the testator was an accomodation endorser of notes, the maker of which became his legatee. After testator's death, the executor had to pay them and the legacy was reduced. A debt due by the legatee unenforceable for any reason except the statute of limitations, can not be deducted from the legacy. The running of the statute of limitations does not extinguish the debt but merely bars the remedy, and an impartial distribution of the estate requires the retention of funds to liquidate the debt. Certain recent cases indicate a trend away from this position.

An overpayment of a legacy will not be credited to an executor but he has a right to recover it from the legatee. If his mistake was reasonable and in good faith, his expenses in a suit against the legatee might be allowed as administration expenses. If a legatee is unknown or cannot be located, the legacy may be paid into court or to designated state officials. A legacy or devise to a witness to the will, required to testify in its admission, is void, but many states allow him the share he would have received as heir or next of kin, not to exceed the value of the gift by will. He is allowed to recover from devisees or legatees in proportion to and out of property given to them.

Current Bookkeeping.—Estate account represents the undivided ownership of assets by the legatees. The decree of distribution following the settlement of the executor's accounts fixes the share due each legatee, and then the credit balance in Estate is distributed among

accounts with legatees. An individual account with a legatee should be opened and debited when any payment is made to him or for his account or when any asset is delivered to him. At the time of the decree of distribution, legatees' accounts normally have debit balances. These will be offset or converted into credit balances by credits for the legacies. When final distributions of cash or assets have been charged, these accounts will be closed.

Accounting.—In the summary of his account, the executor takes credit for all payments to or on account of legatees, including inheritance taxes chargeable to them. A supporting schedule shows the amount of each legacy and the payments on account of it.

Descent and Distribution

Law and Practice.—An executor or administrator normally is not concerned with the descent of real property but he should be familiar with it because realty may be used for the payment of debts or for other purposes. The general principles of descent are similar to those of the distribution of personal property, with which the administrator is always and the executor sometimes concerned, and both may be discussed together. An executor needs to know the laws of distribution if there is no residuary legatee.

If a man dies wholly intestate or intestate as to certain property not disposed of by will, the law directs the disposition of his property. Real property descends immediately to the heirs under statutes of descent. Personal property is distributed to the next of kin under statutes

of distribution. These statutes vary among the states but there are three matters of universal interest; degrees of relationship, taking per stirpes and per capita, and advancements.

Relationships by blood are divided into descendants (children, grandchildren and great grandchildren), ascendants (parents, grandparents, and great grandparents), and collaterals (brothers and sisters, nephews and nieces, uncles and aunts, and others). Proximity of relationship is indicated by degrees of consanguinity. In most states, the degree for a descendant is found by counting down the line from the intestate, allowing one degree for each generation; a child is in the first degree, a grandchild in the second, and a great grandchild in the third. The degree for an ascendant is similarly found by counting up the line; a parent is the first degree, a grandparent in the second, and a great grandparent in the third. The degree for a collateral is ascertained by counting up the line from the intestate to the common ancestor and then down the other line to the relative in question; a brother or sister is in the second degree, a nephew or niece in the third, an uncle or aunt in the third, and a cousin in the fourth.

When all heirs or next of kin are in the same degree of consanguinity, all receive equal shares. The property is divided into as many parts as there are heirs or next of kin and each receives one part. To speak technically, it is divided per capita, a Latin expression meaning per head. The number of deceased ancestors of present recipients is immaterial. If four cousins are to receive

property, each gets one fourth, although three may be children of one uncle and one a child of another uncle.

If heirs or next of kin are of unequal degree, the more remote take per stirpes, representing their deceased parent. Per stirpes means according to the stock or family. Recipients represent their deceased parent by taking the share that the parent would have taken had the parent himself survived; all children of a deceased parent divide what he would have received among themselves per capita. If the heirs are one uncle and three cousins, the children of a deceased uncle, one half goes to the surviving uncle and one half to the three cousins, each receiving one sixth. Next of kin were not mentioned in this illustration because the doctrine of representation, or taking per stirpes, usually does not apply to the distribution of personal property among collaterals more remote than descendants of brothers and sisters.

The doctrine of representation does not apply to any of the original group of relatives who would have been heirs or next of kin, if all of that class predecease the intestate. Their children then become the heirs or next of kin and they share with the issue of any deceased member of their own class. Assume that the intestate had two brothers, both of whom died before the intestate, and that the heirs or next of kin are two children of one of the brothers and three grandchildren of the other brother, all three having one father. If the doctrine of representation applied to the two original brothers, the estate would be divided in halves, each child receiving one quarter and each grandchild one sixth. But it does not apply because all of the original class, both brothers,

predeceased the intestate. The property will be divided into as many parts as there are members of the next class after the first, both living and deceased. That class consisted of three nephews, two living and one dead, and the division will be into three parts. Each child will take one third, and the remaining third will be divided among the three grandchildren, one ninth each, because they represent their deceased father who would have been entitled to one third had he survived.

An advancement is a transfer of real or personal property to a person to whom the donor stands in the position of parent in anticipation of the share of the donor's estate which the donee would receive if the donor died intestate. The parent is presumed to intend to treat all of his children equally and the amount of any advancement must be included in the intestate's gross estate or property before its division into shares required by the statutes of descent and distribution. Advancements thus thrown back into the estate are said to be in hotchpot, which is the blending or mixing of property belonging to different persons in order that it may be divided equally. The donee is not required to account for any profit made on or through an advancement. What constitutes an advancement is in each case a question of fact. Payment of a child's debt is generally regarded as an advancement but the expense of maintaining and educating him is not so regarded. Advancements are cancelled by a subsequent will because the making of a will rebuts the presumptions that the gift was in anticipation of the parent's death and that the parent intended to make an equal division among all his children.

Current Bookkeeping.—When an administrator discovers an advancement of personal property, which cannot be charged against any share of real property to which the donee will ultimately be entitled, he should debit the amount of it to a personal account with the donee, making the corresponding credit in Estate account. With this exception, there is nothing in the current bookkeeping for descent and distribution which differs from the procedure required for legacies.

Accounting.—The procedure for legacies applies also to the accounting for the distributive shares of the next of kin.

CHAPTER VIII

INTERMEDIATE AND FINAL ACCOUNTINGS

Law and Practice.—An estate is ready for distribution when its assets have been brought under the representative's control, so that they are known, when those which should have been reduced to cash have been so reduced, when its expenses and obligations have been ascertained, and when those which should have been paid have been paid. The representative then renders to the court a report showing what cash and other personal property he received, what payments and distributions he made, and what remains in his custody. This report is an affidavit reciting the important facts of his administration and a financial statement. Together they form his Account of Proceedings, or final account. The court passes on or judicially settles it, and issues a decree of distribution directing him to retain a specified amount for commissions and allowances and to distribute the remainder in specified amounts to specified persons. This final distribution should not be delayed until all assets have been reduced to cash; the decree will direct the distribution of unsold property at its cash value.

A final account is not final in the sense of being the last which a representative may ever render. It is conclusive only as to matters contained in it and as to persons cited in the proceeding. If any matter is omitted or fraudulently misstated or if a person interested is

not cited, the representative may be required again to account. Recently, a court opened an estate settled for twenty-eight years; another required an executor whose account had been settled to collect money and to pay it to the widow. Notwithstanding the settlement of his account, the executor continued in office for any duty requiring his action.

A final account may be rendered voluntarily or in a proper case it can be compelled. An estate can usually be settled without an accounting by filing an agreement executed by the interested parties, an expedient useful in small estates. In addition to the so called final account, the representative may voluntarily file or be compelled to file an intermediate account to disclose his transactions to date and the condition of the estate. An intermediate account is usually not judicially settled although it may be so settled in whole or in part. Estate assets charged to the representative are presumed to be in his possession except as he can lawfully account for payments or distributions. When a credit claimed by him is disallowed by the court, he is surcharged for it and the balance shown by his account is increased. To reduce his personal loss, he can sue a legatee or creditor who was overpaid.

The law rarely prescribes a form for the account but custom establishes one. The New York form is used in the illustration below. It is a summary statement of charges and credits with a supporting schedule to show the details. Each important item in a schedule can be further analyzed in a supporting statement and if necessary the process can be carried further by substatements.

Separate summaries for principal and income are usual, each with supporting schedules, and if schedules are numerous an index of them should be provided. In a small estate, a printed form supplied by the clerk of the court can be used with typewritten schedules attached. If there is more than one accounting, each except the first should be based upon the one preceding, and should not include transactions covered by former accounts.

Proceedings for the settlement of the account are started by a petition to the court. This should show when letters were issued to indicate that sufficient time has elapsed to warrant the accounting, that the time for presentation of claims has elapsed, and whether the representative has advertised for creditors. It should give the names and addresses of all persons in any way interested in the accounting or what efforts have been made to ascertain them if they are not known.

The representative's account should be filed with the petition so that it can be examined by any person interested. The court will hear objections to the account and will then enter a decree approving it as filed or corrected. In some states, vouchers for every payment exceeding a small specified minimum must be filed with the account, to be retained by the court for a prescribed period and then returned to the representative or destroyed. This proved so burdensome in New York that the law there was changed and the representative files no vouchers except upon written demand by a person interested. But he should procure vouchers in duplicate for every payment made, to be prepared to file one and retain the other. In some New York courts, vouchers

are still required from every creditor and legatee who is not named in the petition as a person to be cited.

A summary of the executor's account in the New York estate used in Chapter V has been prepared. Schedule A includes all moneys and property received by the executor and all gains on realization. Schedule B shows all claims due to the estate not collected or collectible, all property unsold or lost by accident, and all losses on realization. Schedule C shows administration, funeral and other expenses. Schedule E lists all payments to creditors and Schedule F all payments to legatees, husband, widow, or next of kin. There are three information schedules. Schedule D lists all claims of creditors allowed or disputed, showing those for which a judgment or decree has been rendered, and any personal claim of the representative to be approved on the accounting. Schedule G gives names, addresses and degrees of relationship of all persons entitled to share in the estate. Schedule H shows any other facts to be brought to the court's attention.

Summary of Executor's Account

First, as to Principal:		
I charge myself as follows:		
With amount as shown by Schedule A		$193,525.00
I credit myself as follows:		
With amount of Loss on sales, per Schedule B....	$ 400.00	
With amount of Debts not collected per Schedule B..	.....	
With amount of Schedule C	11,264.24	
With amount of Schedule E	2,500.00	
With amount of Schedule F	9,550.13	23,714.37

Leaving a balance of Principal of		$169,810.63
Second, as to Income:		
I charge myself as follows:		
With amount of Income collected, per Schedule A 1.....	$6,075.00	
I credit myself as follows:		
With amount of expenses applicable to Income per Schedule C 1	1,100.00	
Leaving a balance of Income of.....		4,975.00
Leaving a total balance of Principal and Income of		$174,785.63

to be distributed to those entitled thereto, subject to the deductions of the amount of my commissions, and the expenses of this accounting.

The said Schedules, which are severally signed by me, are part of this account.

Comments on Summary of Executor's Account.—The Summary of Account as to Principal was prepared entirely from the Estate account in the ledger except as to Schedule F. The total of Schedule A is composed of the inventory of $193,025 and the gain on sales of $500. The amount of Schedule B is the loss on sales. Schedule C, $11,264.24, includes the following items:

Expenses	$ 5,500.00
Funeral Expenses	700.00
Federal Estate Tax	5,064.24
Total	$11,264.24

Schedule E contains only the Debts.

Schedule F was prepared from the personal accounts with legatees:

Cash advanced to Samuel Thompson.....	$5,000.00
Transfer Tax for Samuel Thompson.....	475.00
Jewelry delivered to Jane.....	1,500.00
Transfer Tax for X Trust Company	2,575.13
Total	$9,550.13

The summary as to Income was prepared from the Income account on the ledger.

The total balance of Principal and Income, $174,-785.63, is represented by the following assets shown on the trial balance at the time of accounting (see page 45):

Coal Company Stock	$ 60,000.00
Steamship Company Bonds	50,000.00
Cash	64,785.63
Total	$174,785.63

The net gain or loss can be shown in Schedule A or B as may be required but it is preferable to show the gain in Schedule A and the loss in B. Even if a net gain is shown in Schedule A the representative's commissions can not be computed from the Summary alone, because specific legacies must be deducted and income collected must be added. (See page 82.)

The expense of preparing the account does not appear in it but is covered by an allowance out of the balance. This is usually included in the Bill of Costs and described as "Allowance to Accounting Party, — days, necessarily occupied in preparing account." The allowance per day in New York is now $25. The representative is seldom permitted to pay counsel a round sum, such as $1,000, for the preparation of his account.

The compensation of the representative usually is commissions at fixed rates on receipts and payments, the balance shown by the account being counted a payment because he will pay it under the decree of distribution. He must not withdraw his commissions until they have been judicially ascertained upon the settlement of his account. If he does, he will be charged interest unless he can show that no loss was sustained by the estate, or that the persons entitled to the income consented. He is permitted to retain estate funds, prior to his accounting, sufficient to pay his probable commissions.

In the estate used as an example, the executor's commissions were computed as follows:

Total Principal received, per Summary of Executor's Account		$193,525
Deduct: Loss on Sales, per Summary of Executor's Account	$ 400	
Specific Legacy to Jane	1,500	1,900
Net Principal received		$191,625
Total Income received, per Summary of Executor's Account		6,075
Total amount subject to commissions		$197,700

5%	on $ 2,000	$	100
2½%	" 20,000		500
1½%	" 28,000		420
2%	" 147,700		2,954
Commissions on $197,700		$	3,974

The net Principal received, $191,625, is 97% of the total amount subject to commissions, $197,700, and accordingly 97% of the commissions of $3,974, or $3,854.78, is chargeable to Principal and 3%, or $119.22, is chargeable to Income. (See Cash Book, page 47.) Principal

and income are combined in computing commissions so that the successive rates of 5%, 2½% and 1½% will be applied only once. If the amount subject to commissions is $50,000 or more, commissions will be 2% of the total plus $20, because commissions on $50,000 are $1,020, which is 2% of $50,000 plus $20, and commissions on the excess over $50,000 are at 2%.

The expense of executor's commissions on principal falls on the residuary legatee. Commissions are not allowed on specific legacies because the representative has no duty with them beyond delivering specified articles just as he received them. General legacies are not subject to deduction for commissions applicable to them. In an intestate estate, the administrator's commissions, at the same rate as for an executor, are borne by each of the next of kin because they are deducted, with other expenses, in ascertaining the net estate to be divided.

One half of the commissions is for receiving the estate cash and property, and one half for the paying out. If funds received are lost by accident or theft, without representative's fault, he is entitled to one half commissions on the amount received, and one half on the smaller amount paid out. In this calculation, care must be taken not to duplicate fixed percentages, such as 5% on the first $2,000.

If there are co-executors, and the estate is large, each may receive full commissions. In New York, if the gross principal is $100,000 or more, each is entitled to full commissions unless there are more than three, when the compensation to which three would be entitled is apportioned among them according to services rendered.

In determining the estate's size, specific legacies are deducted because no commissions are allowed on them.

If the will provides a specific compensation to the executor in lieu of commissions, he will not be entitled to legal commissions unless he promptly renounces it. In New York, he must do this in writing within four months from the date of his letters. He cannot wait to see which compensation will be larger. Nor is he allowed to assign his commissions in advance. In one case, an executrix agreed to turn her commissions over to a banker as consideration for his advice. He sued her but failed because the contract was illegal. But a representative may waive his commissions. If one person is both executor and trustee, he can receive commissions in each capacity, provided he has definite duties in each. If the functions of executor and trustee co-exist inseparably from testator's death, commissions in both capacities will not be allowed.

A representative may be penalized for misconduct, such as gross mismanagement, by denying him commissions, but this is not often done where there has been no bad faith. It is more usual to charge him personally with losses due to his mismanagement; for example, with a debt when the debtor became insolvent while the executor was neglecting to collect it.

Current Bookkeeping.—At the time of each accounting, the cash book should be posted and all accounts such as Expense Principal, Debts, and the like closed into Estate or Income. General and specific legacies may be credited to legatee's accounts if there is no probability of

abatement. The ledger will then show assets and amounts due from legatees for advances offset by amounts due to legatees and the undistributed balances due to the principal and income interests in the estate. (See Trial Balance per Accounting, page 45.)

After the decree of distribution, commissions and allowances should be entered in the cash book and charged to Estate and Income, the latter accounts should be distributed to personal accounts with legatees, and cash book and journal entries made to record the final distribution of assets. This procedure will completely close all ledger accounts.

CHAPTER IX

TESTAMENTARY TRUSTS

A testamentary trust is one created by will. Calling an executor a trustee does not make him one and no trust can exist without (1) a designated cestui, (2) a designated trustee, other than the cestui, and (3) a fund to which the trustee can take title. A trust, except for charity, is usually void if it suspends the power of alienation, the power of anyone to transfer the trust property, for a period longer than the duration of two lives in being at the time of testator's death. A trust for a specified number of years is generally void and income may be accumulated in the trust only during the minority of a cestui.

An executor holds estate property as estate assets until he sets aside the trust fund. At that time, the trustee's work begins although the executor's administration may not have been completed. Persons interested in the trust fund can compel the executor to set it aside if there are available assets. Recently a trustee was held personally responsible for a defalcation by an executor because the trustee delayed in securing the fund.

A trustee is held to about the same degree of responsibility as an executor except that he has slightly more freedom. A testator may specify securities to compose the fund, or he may leave the matter of investments to the trustee, even relieving him from personal responsibility.

Beneficiaries of full age may ratify the acts of the trustee. A trust company as trustee does not take an oath or file a bond, but it files a consent to accept the appointment. It may in most states deposit trust funds with itself, whereas an individual trustee is never allowed to do so.

Testators frequently appoint more than one trustee. Co-trustees, unlike co-executors, act jointly and all must join to make their action legal. The testator may empower trustees to act by a majority of their number or he may designate certain acts to be performed by a single co-trustee or by less than a majority. One person may act as trustee for more than one trust, but he must keep the principal and income records of each trust distinct although he need not keep an asset account for each trust's share of cash or other funds owned in common. Borrowing from Income to make investments for Principal is bad practice. Beneficiaries should receive income promptly.

The compensation of a trustee usually is based on receipts and payments and where it consists of commissions, the rates as a rule are the same as those for executors. A trustee should account annually to his beneficiaries to secure the highest commission on income. In New York, he need not file annual accounts in court but he must render them to the beneficiaries if he wants his commissions calculated on each year's income as a unit; otherwise, his commissions will be computed on the total income covered by each accounting. If a trustee purchases improved realty on foreclosure of a mortgage and thereafter leases the property to tenants, he is allowed commissions on the gross rent without deduction for taxes and upkeep. But a trustee who operates a business re-

ceives commissions on only the net income from it, although one tried to secure them on its total sales. Commissions are not allowed on investments and reinvestments in securities.

A trustee's bookkeeping is more simple than an executor's. All he requires is accurate accounts for property forming the trust fund, a Principal account, an Income account, and an account with each beneficiary, unless beneficiaries are few and cash settlements are regularly made. The trustee should keep his books by double entry and this necessitates additional accounts when bond premiums are to be amortized or unusual transactions occur. A columnar cash book to separate receipts and payments on Principal from those on Income is useful in large trusts, but an attempt to make the cash book show currently the exact balance available for Principal as distinguished from Income will be more troublesome than useful. Principal and Income accounts should show the total amount of cash and other property due respectively to each.

The chief problem of the trustee is differentiation between principal and income. The life tenant is entitled to the exact, legal, net income and the remainderman to the exact, legal principal. The principal is the property itself which constitutes the trust fund. Increases or decreases in the value of that property belong to Principal. The testator may give these increases to the life tenant but the word "income" when used alone is not sufficient to do it. Income is the proceeds produced by Principal, the profit which comes from its use. Investments must not be unnecessarily safe at the expense of a fair income

rate, nor should they be overprofitable at the expense of safety. The life tenant is entitled to receive only the net income from all sources for the entire term of his tenancy. He is not allowed to take income during profitable years without bearing losses during others, or to select the income from only those investments which are lucrative. The responsibility of the life tenant for expenses in connection with income is limited to the gross income.

Cash Receipts Credited to Principal.—Dividends declared before testator's death or after that of the life tenant belong to Principal, because Principal was the real owner of the stock at the date of declaration. Dividends do not accrue from day to day like interest and they can not be apportioned on the basis of earnings because there is no way of ascertaining when the profits distributed by the dividend were actually earned. Profits of a corporation belong to it until a dividend distributing them has been declared. The date when a dividend is payable is immaterial.

Stock dividends have been handled in various ways. Some courts hold that all stock dividends belong to Principal and all cash dividends to Income. The more general rule is to classify a dividend according to what it represents, regardless of the medium of its payment. If it is a distribution of capital it is credited to Principal; if a distribution of income, to Income; if it represents both, it is prorated. Liquidating dividends belong to Principal and so do proceeds of a sale of rights to purchase new stock. Proceeds from the sale of stock belong to Prin-

cipal although a profit is realized, unless the stock sold carries ownership in undivided profits earned after its acquisition, when the proceeds of the sale should be prorated.

Interest accrued as of the date of death belongs to Principal.

Cash Receipts Credited to Income.—Dividends declared during the life tenancy belong to Income unless the presumption that they are out of earnings is rebutted. Principal must not be credited with the entire proceeds of the sale of bonds if accrued interest is included. The inclusion of accrued interest in the selling price is a collection of such interest, to be credited to Income. A similarly wrong treatment of accrued interest on the purchase of bonds will rarely offset the error; in a large estate the net adjustment between Principal and Income to correct these errors will frequently be a substantial amount.

Any commission or bonus received by the trustee on the making or renewal of a loan must be credited to Income.

Cash Receipts Prorated Between Principal and Income.—Extraordinary dividends, whether cash or stock, which reduce principal are to be prorated between Principal and Income. If a dividend reduces the value of stock below its value when acquired, such portion of it must be credited to Principal as will preserve the trust fund in its original amount. Otherwise, the life tenant

would profit at the expense of the remainderman who ultimately would receive a depleted fund.

If an uncollectible deficit results on the foreclosure of a mortgage held by the trustee, the net proceeds realized must be apportioned between Principal and Income on the basis of principal and accrued interest due. This rule holds even if the mortgage provides that the proceeds shall be applied first to delinquent interest, because that provision affects only mortgagor and mortgagee. If the trustee bought the property on foreclosure and later sold it at a price insufficient to satisfy both debt and accrued interest, the same apportionment of the net proceeds would probably be made. If the sale produced more than enough for these two demands, the excess should be credited to Principal as a capital gain.

Investments received from testator not in securities prescribed for trust funds, must be converted or reinvested as soon as practicable. This conversion may require time if loss is to be avoided, and in the meantime, the life tenant is not entitled to the entire income if larger than an authorized investment would produce. Conversely, a shortage of income may be made up out of the proceeds of the conversion. A mathematical apportionment is adopted by some courts. The net proceeds and the actual income are treated as the sum of an authorized investment and interest on it at a rate reasonable for trust funds. To Principal is given the present worth of the hypothetical investment as of the beginning of the trust, and the remainder of the net proceeds is treated as income. If the period of conversion extends over a year, annual rests are allowed.

Cash Payments Charged to Principal.—Most payments of this type are similar to the executor's Expense Principal. The most common example is attorney's fees and court costs in connection with the existence of the trust or its fund, to construe the meaning of the will creating the trust, for the appointment or removal of the trustee, to secure possession of trust assets, to defend the trustee's title to them, to protect the assets, and other proceedings to preserve the estate as a whole. The life tenant in effect bears part of this burden because the fund which produces income is reduced. Courts occasionally will prorate counsel fees or charge them to Income. In a change of trustees solely for life tenant's convenience, as one to substitute a trustee who lives in his city, the expense would probably be charged to Income.

Commissions to brokers or agents on the purchase or sale of land are borne by Principal by being added to the purchase price or deducted from the selling price. Improvements and repairs to purchased premises to make them income producing are charged to Principal, the purchase price being presumed to have been lower than it would have been if the improvements been made by the seller. Delinquent taxes on property purchased on foreclosure are included in the cost of the property, although current taxes would be borne by Income.

Cash Payments Charged to Income.—Ordinary expenses of management are borne by Income. Rent of a safe deposit box, stamps or other taxes on the sale of securities, the cost of forwarding and collecting interest coupons, postage, stationery and office salaries and ex-

pense, commissions on the collection of income and on changes in investments, trustee's commissions on income, premiums on the trustee's bond, attorneys' fees to oust a delinquent tenant, are examples of expenses of this nature.

Repairs, maintenance, and general upkeep of trust property fall upon the life tenant. He must not commit waste but he need make no provision for depreciation or for obsolescence. Repairs made immediately preceding the life tenant's death are charged to Income although they happened to benefit the remainder estate exclusively. The accident of death does not change the rule.

Betterments made by the trustee are chargeable to Principal. A New York case held that improvements must be charged to Principal even though they did not result in an appreciation in value, where the income from the property was less than one quarter of the cost of the improvements. The life tenant has no duty to make permanent improvements and he is not allowed reimbursement for them. This holds even where he erroneously believed he was sole owner, and in one case where he similarly thought that his son, who had a contingent interest, would be the remainderman. Some states provide by statute that when a life tenant makes improvements in the belief that he is the sole owner, he may recover for them.

County and city and other ad valorem taxes are chargeable to Income but special assessments for improvements may be charged to Principal or in some cases apportioned by having the life tenant pay interest on the amount of the assessment. If the assessment is for a temporary im-

provement which must be renewed from time to time, it falls upon the life tenant.

A trustee has no absolute duty to insure trust property because either the life tenant or the remainderman may insure his own interest. But a trustee may insure and in that event premiums are chargeable to Income unless the insurance exceeds the value of the life estate and thus protects both interests. The premiums then are apportionable between Principal and Income.

Non-cash Items Affecting Principal and Income. —Realized losses on trust assets are chargeable to Principal and when securities depreciate in value because of property losses incurred by the corporation which issued them, the loss falls upon Principal. When uninsured houses or other improvements to real property are damaged, the loss falls upon the life tenant if the damage was due to his negligence. Otherwise the trustee should at once restore the property to an income-producing basis, charging the cost of reconstruction to Principal.

When a trustee buys bonds at a premium or at a discount he must amortize the premium or accumulate the discount to preserve the trust fund intact. If he fails to do this in the first case, the remainderman will suffer because the bond premium paid for out of Principal can not be recovered at maturity; in the second case, the life tenant will suffer because the bond will be redeemed at par and the discount will thus become a capital gain instead of an increase in nominal income bringing it up to the effective rate. On an interim sale, any loss or gain on the amortized or accumulated value belongs to Principal.

Bonds in the trust fund which were purchased by the testator are not subject to this rule. There the bonds themselves constitute the trust found and their value is immaterial because the trustee is under no duty to keep intact a fund of money. The testator is presumed to have intended all interest collected on the bonds to be income.

Another trust asset which may require amortization is a lease for a fixed number of years which has been sublet but which will expire during the life tenant's expectancy of life. The value of the lease as of the beginning of the trust constitutes the trust asset which must be preserved intact. The net income, consisting of rent from the subtenant less rent to the landlord and direct charges such as taxes and repairs, should be reduced periodically by such an amount as will amortize the calculated value of the lease and leave a like amount in the trust fund at its expiration. When practicable, it is wiser to sell the lease and invest the proceeds in something requiring less mathematical adjustment.

When mortgaged real property was left by testator in trust, its net value constitutes the trust fund and the life tenant is entitled to income only on that net value. The mortgage interest is chargeable to Income but payments on the mortgage debt must be borne by Principal. If a trustee should acquire mortgaged realty, an unusual but possible case, interest to date of purchase is chargeable to Principal by being included in the purchase price; interest thereafter falls on the life tenant.

CHAPTER X

INHERITANCE TAXATION

A representative has always been confronted with certain taxation problems but within the last fifteen years the scope and intricacy of them have vastly increased. Formerly, he was concerned with his duty to pay local taxes on personal and real property; today, he has to deal in addition with income and inheritance taxation. The power to tax is the power to destroy and the representative should be prepared to avail himself of all lawful means in thwarting every unauthorized assessment. Unfortunately, much illegal taxation is successfully enforced partly because representatives are not fuly aware of their rights and partly because the amounts involved are not large enough to justify litigation. In this chapter, a brief summary of inheritance taxation will be given, in the hope that it may help to inspire readers to further study.

Basis of Tax.—An inheritance tax, by whatever name it may be called, is a tax on the passing of property at death. It is a tax not upon the property itself but on the right to transfer or receive it. Hence it follows that though the property itself be wholly exempt from taxation, the inheritance tax will nevertheless be imposed upon its transfer. Since it is not a property tax, it need not be uniform and its burden need not be equally distributed

among those who pay it. Inheritance taxes apply to all transfers which effectuate succession of property at death; transfers by will, by descent and distribution, and by gifts in contemplation of or to take effect at death. Transfers for a fair consideration are not subject to taxation even though they be in contemplation of death, because the total value of the transferor's property has not been decreased. The law usually provides that gifts within two years of death are presumed to be in contemplation of it, but this presumption may be rebutted. In a recent New York case, the decedent, within a few months of his death, gave securities to his wife, but the transfer was not taxed because he did not know he had a fatal disease and his purpose was to reduce surtaxes.

The Federal government and forty-six states impose inheritance taxes in one form or another and there is much overlapping and double taxation. The Federal tax is applied in every state but the state tax is seldom confined to its own territory, except so far as the transfer of land is concerned. Transfers of personal property may be taxed in several states. When personalty is tangible, the state having jurisdiction of the property may tax as well as the state having jurisdiction of the estate. Recently, a New Jersey estate was taxed by New York because decedent died leaving jewelry in New York City, which could have been avoided had it been kept in vaults in Newark. When personalty is intangible, its transfer may be taxed in more than two states. Before the representative can secure the transfer of shares of stock, he may have to pay taxes in the state where decedent died, in that where the certificates were found at

death, and in every state where the corporation was incorporated. Large corporations frequently incorporate in more than one state, one railroad being incorporated in the six through which it passes. Some states tax transfers by a non-resident of stock in a foreign corporation, if the corporation has property within the state, but this has been held unconstitutional by some courts.

The representative usually is charged with the payment of taxes, with a personal liability if he defaults. The burden of the tax generally falls on the individuals who receive decedent's property. Taxes are assessed against them according to their degree of relationship to decedent, the more remote paying a higher rate, and according also to the value of the property transferred. The Federal estate tax and similar taxes in Mississippi and Utah, however, impose the burden upon the estate as a whole. Oregon and Rhode Island have a combination of both systems and Mississippi had a similar combination until 1924. Some of the features of each type of inheritance taxation will be discussed as an indication of the problems involved.

Under the more common system where taxes are borne by individual beneficiaries, the nearest relatives are taxed at a low rate with liberal exemptions. For example, in New York the first $5,000 received by a father, mother, husband, wife, or child is exempt and the rate on the next $25,000 is only one per cent. In this group, the rate reaches four per cent when the amount in excess of the exemption is over $200,000. The tax on a transfer of $29,000 would be $240, but on a similar transfer to a niece it would be $1,490. Recently, a niece assigned her

legacy to decedent's widow. The widow, as assignee, was obliged to pay the tax of the niece as legatee, but if the niece had renounced her legacy, in that particular estate it would have passed to the widow as residuary legatee. The transfer then would have been taxable at the lowest rate, and on a legacy of $29,000 the widow would have saved $1,250.

Computation of Tax.—In order to ascertain the amount of the taxable transfer to a residuary legatee or devisee, it is necessary to appraise the entire estate as of the date of death and then, by a series of deductions, to determine the amount of the residue. In both the appraisal and the deductions there may be differences of opinion and the representative should be aware of his rights. The appraisal of closely held corporate stock should be scrutinized. When there were no sales, its value cannot be fixed by market quotations but it must be ascertained from the corporation's books. This is neither simple nor easy. It involves a valuation of the corporation's goodwill, fixed assets, deferred charges and credits, sinking funds, and reserves, and other refinements of corporation accounting.

Among the deductions from the gross estate, to determine the residue, are funeral expenses, estimated administration expenses, and debts. These deductions should be as liberal as the law of the state will permit. One item frequently overlooked is the full amount of all exemptions for the immediate family. In New York, these include not only household furniture and other things not exceeding specified amounts in value, but also money not

exceeding $150. The estate is entitled to this deduction for $150 but it is not always claimed. Another deduction which requires care is the estimate of the representative's commissions or compensation which cannot be exactly determined until his administration ends. If there is a testamentary trust, the trustee's commission on the principal of the trust may be deducted but frequently it is not claimed because the tax law rarely makes specific mention of it. The New York Regulations cover this and henceforth in that state it can be missed only through gross negligence. As a rule, the Federal estate tax cannot be deducted. This of course is wrong because that tax reduces the estate passing to beneficiaries and this matter is now being litigated. Since the Federal estate tax can not be deducted in determining the residue, it need not be deducted in computing the trustee's commission when the residue forms the principal. This also is wrong but it is consistent and it reduces the tax. After the residue has been ascertained, the tax on each individual transfer must be computed. On ordinary legacies or devises this is a simple matter of claiming each personal exemption and applying the proper rate. On a trust with a life estate it is more difficult. The practice in New York is substantially as follows:

When the life tenant is given the right to receive the income from the trust, it is necessary to determine the principal of the fund, to estimate the amount of annual income, to determine the life tenant's expectancy of life, to calculate the present value, as of the date of death, of an annuity of the expected income, and to compute the tax for the life estate upon that present value. A

number of these questions are actuarial and in New York they are settled, in each case, by the superintendent of the state insurance department, but the method should be understood.

If the trust fund is a specified sum of money or specified property, the principal is the money or the value of the property. But if the principal of the trust is the residue of the estate, the determination of its amount requires careful calculation. If possible, the trustee's commission on principal should be deducted in fixing the amount on which income is to be calculated, so as to reduce the income and the present value of the annuity. The rate of income is generally fixed by law from 3½% to 7%. In New York it is 5%. The amount of annual income at the prescribed rate becomes the annuity. The expectancy of life requires the use of a special mortality table showing the life tenant's chances of living the number of years indicated by experience to be the expected life of the average person of his age. If out of a group of 100,000 persons, 78,862 are living at age 39 and 78,106 are living at age 40, the chances of a person aged 39 years to live to be 40 are .9904 and the present value of an annuity for that year is .9904 of the present value of an annuity certain for one year. The present value of an annuity certain for 28.9 years is 15.141 whereas the present value of an annuity on the probability at age 39 of living 28.9 years is 13.881.

The value of the life estate for tax purposes thus calculated is not affected by the actual length of the life tenant's life. The tax should be paid by the trustee and deducted pro rata from each annual income payment, in

order to reimburse the principal. The life tenant might pay this tax personally if the income earned by the trust was substantially higher than he earned on his personal investments. The remainder in the trust estate is usually appraised as worth the excess of the total principal over the value of the life estate. The tax on the remainder is paid by the trustee out of principal. This reduces the fund on which the income is to be earned but it would be unfair to compel the remainderman to pay at once for a fund he may not live to receive. In some states he is permitted to file a bond for the payment of the tax when he receives the fund, but this compels the taxing authorities to keep track of the trust for years. The usual plan is probably the least inequitable.

This type of inheritance tax is the most difficult to apply. The New York Regulations for Taxable Transfers, June 5, 1924, state: "The transfer tax law is one of the most intricate statutes of the state and presents an almost unlimited number of questions difficult of interpretation." The Commission could properly have added that in the practical interpretation of most of these questions, a knowledge of accounting, particularly estate accounting, is just as essential as a knowledge of law.

Estate Taxes.—The other type of inheritance tax is that which is assessed against the estate as a whole, the most notable example being the Federal estate tax. The residuary legatee or devisee bears the burden of it, because it is a charge against the estate like debts and expenses. Recently the Young Men's Christian Association was residuary legatee and it unsuccessfully contended that to pay

the Federal estate tax out of the residue would tax a gift or a beneficiary exempt from taxation. The United States Supreme Court held that, "These donees do not pay the taxes any more than they pay the funeral expenses, the lawyers, the executors, and the testator's debts." Degrees of relationship and amounts of legacies or devises are immaterial. In the Federal estate tax, the gross estate is determined, certain deductions including a specific one for $50,000 are made, and the tax is assessed on the net estate. The gross estate includes all life insurance payable to beneficiaries other than the estate, in excess of $40,000, but the legality of this is being litigated. Another inequity which should be contested is the interpretation of the law found in Article 15 of Regulations 63. When decedent was entitled to receive an annuity of a definite amount during the life of another person, its present worth must be computed on a 4% basis. Since safe investments everywhere yield more than 4%, the use of this rate gives too high a valuation. The amount of income in dollars is fixed; the amount of principal required to produce it at 4% would be greater than at a higher rate.

Under both types of taxation, penalties are imposed for delay in payment, and in many states a discount for prompt payment is allowed. A representative may be charged personally if he fails to protect the estate or the beneficiaries by avoiding penalties and taking advantage of discounts. Delay by the taxing authorities in making assessment or fixing the tax does not relieve him if it is possible for him to pay an estimated amount, to be adjusted when the tax is finally assessed. An example of this is given in Chapter V.

INDEX